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Financial reporting and changing prices: Supplementary disclosure requirements of FASB Statement no. 33;

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Financial Reporting and Changing Prices

**Supplementary Disclosure
Requirements of FASB
Statement No. 33**

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Financial Reporting and Changing Prices

**Supplementary Disclosure
Requirements of FASB
Statement No. 33**

Executive Summary

Why: In the face of persistent inflation and criticism about the ability of traditional accounting and financial reporting to portray adequately the effects of inflation on sales, earnings and certain assets, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 33, *Financial Reporting and Changing Prices* (the Statement) in September 1979.

Who: The Statement applies only to certain large enterprises—those having total assets of \$1 billion or more, or those having inventory plus property, plant and equipment (gross of accumulated depreciation) of \$125 million or more, measured as of the beginning of the fiscal year. Assets include those in foreign locations as well as in the United States.

What: The Statement requires *supplementary disclosure* (unaudited) of certain information intended to measure the impact of changing prices on the enterprise. The Statement does *not* change the standards of financial accounting and reporting used for the preparation of the primary financial statements of the enterprise.

The major provisions of the Statement require adjustments for general inflation, using an average-for-the-current-year (or a base-year) constant-dollar basis. The index to be used is the Consumer Price Index for All Urban Consumers. Adjustments for changes in specific prices (current cost) also are required. Adjustments for current cost may be based on specific indices or other measurement techniques.

For the current fiscal year, a statement of income from continuing operations adjusted for the effects of changing prices on both a current-cost and a constant-dollar basis is required. Also to be included in this statement are holding gains or losses on inventories and property, plant and equipment held during the year, and gain or loss in purchasing power of net monetary assets or liabilities.

For each of the five most recent years, in addition to data from the above statement, the following information as adjusted for changing prices is required: net sales and other operating revenues, net assets

at year-end, and per-share data for income from continuing operations, dividends and stock prices. Also, management's discussion of the significance of the required supplementary data to the enterprise must be presented.

When: The supplementary disclosures are required to be included in annual financial reports for years ending on or after December 25, 1979. However, disclosure of information on a *current-cost* basis for annual periods ending *prior* to December 25, 1980 may be included for the first time in annual financial reports for years ending on or after December 25, 1980. This represents an effective deferral of disclosure of current-cost data for one year. Other exemptions from disclosure of *current-cost* data are given for certain unprocessed natural resources (from oil and gas production, mining and forest products operations), and for income-producing real estate properties.

Where: The information required should be presented as supplementary information in any published annual report that contains the primary financial statements of the enterprise. It need not be presented in an interim financial report or for segments of a business enterprise. The required information may be presented in statement format, schedules, or supplementary notes to the financial statements.

Caveats: The information required attempts to quantify many concepts that may not be familiar to many users of financial statements. In addition, the disclosures specified by the Statement are based on many simplifications, shortcuts, and abbreviated data. A substantial amount of subjectivity is permitted, and therefore, unwarranted comparisons and inferences may result. Accordingly, management may wish to caution users about the significance of the information.

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Introduction

In September 1979, the Financial Accounting Standards Board (the FASB or the Board) issued Statement of Financial Accounting Standards No. 33, *Financial Reporting and Changing Prices* (the Statement). The Statement requires that certain large publicly held companies disclose certain supplementary information, concerning the impact of changing prices in their annual reports for fiscal years ending on or after December 25, 1979.

The Board recognized that as yet there is no satisfactory accounting solution to giving effect in financial statements to changing prices. As a consequence of the general uncertainty and the lack of consensus among financial statement users, the FASB has taken a cautious and experimental approach. The Board has been more flexible than is customary, apparently to encourage experimentation that would help to develop techniques for accumulating, reporting and analyzing data on the effects of price changes. The Statement requires two different sets of disclosures—one for current-cost information and another for constant-dollar information.

Background

The Statement is the result of more than five years of consideration by the Board on the subject of financial reporting under persistent inflationary conditions.

On December 31, 1974, the Board issued an Exposure Draft of a proposed Statement of Financial Accounting Standards, *Financial Reporting in Units of General Purchasing Power*. In June 1976, the Board deferred action on the Exposure Draft pending further progress on its project on the Conceptual Framework for Financial Accounting and Reporting (the Conceptual Framework). Subsequently, in May 1977, the Board published a Research Report, *Field Tests of Financial Reporting in Units of General Purchasing Power* (the Research Report). In the interim, the Board continued its Conceptual Framework project, holding public hearings in January 1978 on the issues raised in its Discussion Memorandum, *Elements of Financial Statements and Their Measurement*, published in December 1976.

The Statement was developed as part of the measurement phase of the Board's project on the Conceptual Framework. In issuing the Statement, the FASB has considered the results of field tests made by a number of U.S. companies which were published in the Research Report, experience gained by the Securities and Exchange Com-

mission (SEC) through its replacement-cost disclosure requirement in accordance with the provisions of Accounting Series Release (ASR) No. 190, and the results of similar studies, pronouncements and tests in other countries. The Board has concluded, however, that a statement on measurement should not be issued at this time. Instead the Board has concluded that preparers and users of financial reports should have further practical experience with reporting the effects of changing prices. The supplementary information required by the Statement is intended to assist in obtaining that experience.

Objectives of Disclosure Requirements

The Statement establishes standards for reporting information as supplementary data to the historical-cost-based financial statements on the effects of changing prices. The requirements of the Statement, according to the Board, are consistent with the objectives set forth in FASB Statement of Financial Concepts No. 1, *Objectives of Financial Reporting by Business Enterprises* (the Objectives), because reporting current costs is likely to improve the basis for the assessment of future cash flows. Additionally, the Board considers that informing owners about the effects of changing prices is an important element of management's accountability.

The Statement does not in any way modify the measurement concepts used to prepare the primary financial statements, and the required supplementary disclosures do not attempt to solve any issues other than those arising solely from changing prices.

Effective Date

The provisions of the Statement are effective for fiscal years ending on or after December 25, 1979, with the following exceptions:

- The presentation of information on a current-cost basis for fiscal years ending before December 25, 1980 may be delayed until issuance of the first annual report for a fiscal year ending on or after December 25, 1980. This represents an effective delay of one year in presenting current-cost data.
- The information required in the five-year summary of selected financial data (other than net sales and other operating revenues, cash dividends and market price per common share—all adjusted

for general inflation—and the average consumer price index) is not required to be disclosed for fiscal years ending before December 25, 1979.

- Unprocessed natural resources (from forest products, mining and oil and gas production operations) and income-producing real estate properties have been exempted from the current-cost disclosures, but must disclose historical-cost information adjusted for general inflation. According to the Statement the Board intends to publish one or more statements, subsequently, dealing with the assets concerned.

Applicability

The requirements of the Statement apply to public enterprises that (1) prepare their primary financial statements in U.S. dollars and in accordance with U.S. generally accepted accounting principles (GAAP), and (2) have, at the beginning of the fiscal year for which financial statements (consolidated, if applicable) are presented, either:

- Total assets amounting to more than \$1 billion (after deducting accumulated depreciation); or
- Inventories and property, plant and equipment (before deducting accumulated depreciation, depletion or amortization) amounting in the aggregate to more than \$125 million.

If an enterprise is a party to a business combination during the year, that is accounted for as a pooling of interests, and if at the beginning of the year none of the combining companies met the size tests, the enterprise is not required to make the disclosures for that year. However, in subsequent years, the criteria would be applied to the combined entity.

The information required by the Statement need not be presented separately for a parent company, an investee company, or any other enterprise in any financial report that includes the results of that enterprise in consolidated financial statements.

Publicly held non-U.S. enterprises that do not prepare their basic financial statements in U.S. dollars or in accordance with the U.S. GAAP, and nonpublic enterprises are not required, but are encouraged, to present such information.

The FASB's applicability requirements will encompass essentially all of the enterprises that are subject to the SEC's ASR No. 190 requirements. However, the \$1 billion total assets size test also will make the Statement applicable to a number of enterprises that were exempt from the ASR No. 190 disclosures, such as banks, insurance companies and other financial and service institutions that do not have significant amounts of inventories or property, plant and equipment.

Required Supplementary Information

The Statement requires that affected enterprises present certain selected information for the current year and a summary of certain data for the five most recent fiscal years.

Current-Year Supplementary Information

The following supplementary information is required for current fiscal years ending on or after December 25, 1979:

- Income from continuing operations
 - Adjusted for the effects of general inflation—that is, on a *historical-cost/constant dollar* (hereinafter “constant dollar”) basis—and
 - On a *current-cost* basis¹
- Purchasing power gain or loss on net monetary items
- Increases or decreases in the current cost amounts of inventory and property, plant and equipment (commonly known as holding gains and losses), both before and after eliminating the effects of general inflation.
- Explanatory notes

Constant-dollar information must be expressed in dollars having a purchasing power equal to that represented by the average level of the Consumer Price Index for All Urban Consumers (CPI-U) over the current fiscal year. The CPI-U is published by the Bureau of Labor Statistics of the U.S. Department of Labor.²

¹ Not required for fiscal years ending before December 25, 1980, until presented in annual financial reports for fiscal years ending on or after December 25, 1980.

² The CPI-U is described in Appendix E.1.

Supplementary Five-Year Summary

The five-year summary should include the following:

- Historical-cost information (from the primary financial statements adjusted to a constant-dollar basis)
 - Net sales and other operating revenues
 - Income (loss) from continuing operations
 - Income (loss) per common share from continuing operations
 - Net assets at fiscal year-end
 - Purchasing power gain or loss on net monetary items
- Current-cost information³
 - Income (loss) from continuing operations
 - Income (loss) per common share from continuing operations
 - Net assets at fiscal year-end
 - Increases or decreases in the current cost amounts of inventory and property, plant and equipment held during the fiscal period (holding gains or losses), net of general inflation
- Other information
 - Cash dividends declared per common share
 - Market price per common share at fiscal year-end
 - Average level of the Consumer Price Index for All Urban Consumers (CPI-U) (may be in the notes)
- Explanatory notes

The five-year supplementary information must be reported in dollars having a purchasing power equal to either:

- That of dollars of the base period used by the Bureau of Labor Statistics for the CPI-U (presently 1967 = 100), or
- That represented by the average level of the CPI-U during the current fiscal year.

³ See note 1.

If the CPI-U base period is selected, the information in the summary will be restated only when the Bureau of Labor Statistics changes its base period. If average-level-of-the-current-year is chosen, the amounts in the summary must be restated each year to recognize the change in the unit of measure.

If there are no significant differences between historical-cost and current-cost income from continuing operations, the supplementary information relating to current costs need not be disclosed. However, a note to the supplementary disclosures should indicate the reason for the omission of the current-cost information.

The Statement also requires that the financial report include a discussion and explanation by management of the significance of the supplementary information.

Comprehensive Restatement

The Statement encourages, but does not require, the comprehensive restatement of the historical financial statements for supplementary disclosure:

- On a historical-cost/constant-dollar basis
- On a current-cost/constant-dollar basis

Any supplementary information presented on either of the above bases is required to conform to the general disclosure requirements of the Statement. If an enterprise elects to present comprehensive supplementary financial statements on a constant dollar or current cost basis, it may report the required information in either:

- **Average-for-the-current-year** constant dollars, or
- **End-of-the-current-year** constant dollars

Comprehensive restatement is not defined or illustrated in the Statement. Comprehensive restatement on a constant-dollar basis is explained in Accounting Principles Board (APB) Statement No. 3, *Financial Statements Restated for General Price-Level Changes*, which has not been superseded or amended by the Statement. This booklet was prepared on the assumption that an enterprise would not elect to present comprehensive supplementary financial statements. Therefore, the discussion that follows omits any extended consideration of such comprehensive restatement. However, an example of the disclosure required under this option is given in Appendix A.2.

Presentation

The additional information that the enterprise is required to disclose may be presented in supplementary statements, schedules or notes in financial reports. The Statement requires the supplementary disclosures only in the published annual reports that include the primary financial statements; no such disclosures are required in interim financial reports.

The consolidation principles applied in the primary financial statements should be applied in developing the supplementary information. Also, separate supplementary information for a parent company, an investee or any other company does not need to be presented if the consolidated supplementary information includes the data relating to that company.

The presentation of supplementary information for segments of a business in accordance with FASB Statement No. 14, *Financial Reporting for Segments of a Business Enterprise*, as amended, is encouraged but not required.

Information relating to income from continuing operations may be presented either in a statement format, disclosing revenues and expenses, or in a reconciliation format, showing adjustments to the income reported in the primary financial statements. Examples of the alternative presentations are shown in Appendix A.1.

Assets Covered

The assets covered by the Statement are:

- Inventories⁴
- Property, plant and equipment
- Net monetary assets

In general, assets that are classified as inventory or property, plant and equipment in the primary financial statements are classified as such for purposes of the Statement wherever these assets are located. For purposes of the required supplementary disclosures, however, *goodwill* and *other intangible assets* are excluded from property, plant and equipment.

⁴Inventories are defined in Accounting Research Bulletin No. 43, Chapter 4, *Inventory Pricing*.

Specifically, the following are included in property, plant and equipment:

- Land
- Other natural resources
- Capitalized leasehold interests

Also, for a number of reasons, the FASB decided to continue its study of the natural resources and real estate industries.⁵ As a result, the Statement does not require the computation of current-cost information relating to:

- Income-producing real estate properties
- Unprocessed natural resources, such as forest products, mining products, and oil and gas
- Related depreciation, depletion and amortization

However, constant-dollar disclosures are required for all enterprises that meet the size test.

All other items classified as inventories or property, plant and equipment in the primary financial statements are covered by the Statement.

Monetary items are monetary assets and liabilities. The Statement defines net monetary assets (liabilities) as the excess (deficit) in money or claims to receive money, less obligations to pay money, where claims and obligations are not dependent on future prices. (For purposes of this definition, interest rates are not considered to be prices.) All assets and liabilities that are not monetary are non-monetary. An illustrative table of assets and liabilities classified as monetary or nonmonetary is included in Appendix D.

⁵ It is expected that the FASB will issue standards for these industries in the near future.

Inventory and Property, Plant and Equipment on a Constant-Dollar Basis

APB Statement No. 3, *Financial Statements Restated for General Price-Level Changes*, and the FASB's 1974 Exposure Draft, *Financial Reporting in Units of General Purchasing Power*, embodied similar concepts. Both, in effect, required a comprehensive restatement of the historical-cost financial statements to a historical-cost/constant-dollar basis. The terms "general price-level financial statements," "general purchasing power financial statements" and "historical cost/constant-dollar financial statements" have similar meanings and have been used more or less interchangeably in accounting literature.

Constant-Dollar Basis

The Statement adopts the term "historical cost/constant dollar," which emphasizes the fact that the method does not change the historical-cost basis of measurement, but only changes the unit of measure from nominal dollars to constant dollars.

The Statement requires less information than do APB Statement No. 3 and the 1974 FASB Exposure Draft. It limits the disclosures to be made to certain specific items and does not require presentation of comprehensive supplementary financial statements prepared on a constant-dollar basis.

The Board's decision sets aside many concerns inherent in preparing comprehensive statements on a constant-dollar basis, including those relating to stockholders' equity, investments in affiliated and associated companies, and foreign currency transactions and balances.

The general rule for restating historical-cost amounts to constant-dollar amounts consists in multiplying the former by a factor that measures the change in the general purchasing power of the U.S. dollar. Again, the CPI-U is the index prescribed by the Statement to be used to measure changes in general purchasing power. The general restatement rule may be expressed in the following formula:

$$\text{Constant-dollar amount} = \text{Historical-cost amount} \times \frac{\text{average-for-the-year CPI-U}}{\text{date-of-measurement CPI-U}}$$

Amounts expressed in constant dollars of a prior period can be expressed in constant dollars of the current period by using the following "updating" or "roll-forward" formula:

$$\begin{array}{l} \text{Amounts expressed} \\ \text{in current-period} \\ \text{constant dollars} \end{array} = \begin{array}{l} \text{Amounts expressed} \\ \text{in prior-period} \\ \text{constant dollars} \end{array} \times \frac{\text{current-period CPI-U}}{\text{prior-period CPI-U}}$$

Amounts stated in current-period dollars can be restated to constant dollars of the base period used by the Bureau of Labor Statistics to prepare the CPI-U (currently 1967 = 100) by using the following "roll-back" formula:

$$\begin{array}{l} \text{Amounts stated} \\ \text{in base-period} \\ \text{constant dollars} \end{array} = \begin{array}{l} \text{Amounts expressed} \\ \text{in current-period} \\ \text{constant dollars} \end{array} \times \frac{\text{base-period CPI-U (=100)}}{\text{current-period CPI-U}}$$

Procedures To Determine Constant-Dollar Amounts

The steps to be taken to determine the constant-dollar amounts of inventory and property, plant and equipment that are required to compute certain amounts needed for the required disclosures are:

- Determine the measurement dates.
- Determine the applicable indices.
- Compute end-of-current-period constant-dollar amounts of inventory and property, plant and equipment.
- Adjust inventory and property, plant and equipment to recoverable amount, if applicable.

Date of Measurement

A strict application of the constant-dollar method requires that the date of acquisition and cost of each item of inventory and property, plant and equipment be identified. If the cost is incurred over a period (as for manufactured inventory or plant that is assembled), the cost and date of acquisition of each specific component should be determined. Because this is impracticable in most cases, the Statement permits reasonable approximations or estimates.

Inventories

To determine the date of acquisition, different approaches may be taken depending on the type of enterprise and the cost system used. In a manufacturing enterprise, the movement of inventories through the different classes of inventory from raw materials to finished goods makes an exact aging almost impossible. Therefore, assumptions about the way inventories flow through the productive process have to be made.

If a first-in, first-out (FIFO) assumption is used for the flow of materials and expenses, finished goods normally can be presumed to be older than the related work in process and raw materials inventories.

If the last-in, first-out (LIFO) assumption is used, the ages of the inventory ordinarily will be associated with the LIFO layers. Materials and expense, under the LIFO assumption, however, may be presumed to be associated with the latest costs incurred in the current year.

If a LIFO layer is invaded, no particular difficulty arises as a result of the constant-dollar adjustment. The resulting amounts for inventory and cost of goods sold will reflect the historical LIFO flow of costs convention.

If the enterprise uses an average cost system, aging may be estimated by using inventory turnover calculations. However, if turnover is calculated based on monetary amounts under inflationary conditions, the resulting turnover ordinarily will be faster than if turnover is calculated on the basis of physical quantities. Estimation sampling may be used to estimate the potential difference.

Standard costing presents greater difficulties. If variances from standard are allocated to inventories on a systematic basis, a FIFO assumption often can be made. If variances are not allocated, it will be necessary to determine how the standard was constructed to arrive at a conclusion about the periods to which the standard relates.

The Statement recognizes the complexity of aging inventories, and permits alternative methods and shortcut procedures. One of the most useful shortcuts is to group inventories, in some cases without taking into consideration the stage of completion of the goods. The use of turnover indices and similar estimates results in the determination of a range of dates of acquisition rather than specific dates of acquisition.

Also, if inventory has been reduced from cost to a lower market value in the historical cost statements, the date of that reduction becomes the measurement date for the application of the constant-dollar adjustment.

Property, Plant and Equipment

Shortcut procedures and estimates also are permitted in aging property, plant and equipment. Some of the most useful are:

- *Cutoff date.* All acquisitions prior to a cutoff date are presumed to have been acquired as of that date. A 1945 cutoff has been suggested because the CPI-U prior to 1945 is not reasonably comparable with the CPI-U after that date. Also, many enterprises find that the use of a later cutoff date does not introduce material distortions.
- *Placement in service.* Assets are assumed to be acquired in the year that they were placed in service. This ignores the period of construction and could cause distortions if that period is significant, as is the case in some plant construction or other major projects such as dams or railroads.
- *Fully depreciated assets.* Assets that have exceeded the useful life assumed for accounting purposes, and the related accumulated depreciation, need not be aged because the net amount in both historical and constant dollars usually is insignificant; also the failure to age these assets would have no effect on the current year's depreciation expense.
- *FIFO disposals.* Disposed assets are assumed to belong to the oldest age group on a FIFO basis. Significant distortion can be avoided if major disposals are aged separately.
- *Average aging of disposals.* An estimate of the average expired life of disposals can be computed by dividing accumulated straight-line depreciation on the disposed assets by the cost of those assets, and multiplying the result by the useful life used in computing depreciation. Similarly, estimates can be used for other methods of depreciation.
- *Annual averages.* Identification of the year of acquisition is often sufficient. Identification by quarters or months would not ordinarily cause significantly different results.

Applicable Index

The Consumer Price Index for All Urban Consumers (CPI-U) is calculated monthly, and quarterly and annual averages are available. Because the index is calculated over the month, it is an average-for-the-month index; there is no index available for a specific date. However, the use of the index for the last month instead of an index estimated for the last day of an enterprise's fiscal year should not cause significant distortions. Similarly, the use of an average index for the period of acquisition instead of an index estimated for the date of acquisition should be acceptable.

Foreign Assets

Additional considerations arise in adjusting the financial statement items of foreign branches, subsidiaries and investees that are expressed in foreign currency. The Statement requires that the historical-cost financial statements expressed in a foreign currency first be translated into historical-cost financial statements expressed in U.S. dollars in accordance with FASB Statement No. 8, *Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements*. The resulting U.S. dollar historical amounts should then be restated to constant-dollar amounts using the CPI-U.

Constant-Dollar Amount of Assets

The constant-dollar amount of inventory and property, plant and equipment at the end of the current fiscal year is obtained by multiplying the historical-cost amounts by the average-for-the-year index, and dividing the result by the index for the applicable measurement date.

Example:*

Inventory, 12/31/79—as stated in the financial statements	\$12,000
Average-for-the-year CPI-U	217
Measurement-date (date of purchase, fourth quarter 1979) CPI-U	227
Inventory, 12/31/79—as stated in average 1979 constant dollars ($\$12,000 \times 217 \div 227$)	\$11,471

*Data for all examples are taken from Appendix A.1.

Depreciation

The applicable measurement date for accumulated depreciation is not the date the depreciation was recorded, but the measurement date of the corresponding asset. Normally it is impracticable to restate accumulated depreciation by applying the general rule unless shortcut procedures are used. Constant-dollar accumulated depreciation normally is calculated by applying the method and rates of depreciation used in the primary financial statements to the restated constant-dollar value of the assets.

Example:

Property, plant and equipment, 12/31/79— as stated in the financial statements	\$10,000
Accumulated depreciation, as stated in the financial statements	\$ 5,000
Average-for-the-year CPI-U	217
Measurement-date (date of purchase, 1977) CPI-U	182
Property, plant and equipment, 12/31/79— as stated in average 1979 constant dollars ($\$10,000 \times 217 \div 182$)	\$11,923
Accumulated depreciation, 12/31/79—as stated in average 1979 constant dollars ($\$11,923 \times 50\%$)	\$ 5,961

In principle, there should be no difference in depreciation methods, estimated useful lives or salvage value of assets used to compute accumulated depreciation on the historical-cost basis and on the constant-dollar basis. However, different methods or estimates may be used if the elections made for the primary financial statements were made to offset in part the effects of inflation. This may result from the choice of an accelerated method of depreciation or a shorter useful life.

If an enterprise has a significant amount of fully depreciated assets that are still used in the business, the assumptions underlying the determination of the useful lives of those assets should be carefully reviewed. An assumption that the determination of the original useful lives was influenced by inflation considerations may be justified.

Initial Application

In the case of property, plant and equipment and accumulated depreciation, most difficulties are encountered in the initial restatement in constant dollars. Once the initial constant-dollar amounts are determined, the restated amounts need only be "rolled forward" from average-for-the-prior-year constant dollars to average-for-the-current-year constant dollars by multiplying them by the average-for-the-current-year CPI-U and dividing the result by the average-for-the-prior-year CPI-U. Changes during the year (additions, disposals, etc.) should be restated using the general rule, and depreciation for the year should be computed on the restated balances.

Additionally, the historical amounts of the current year's additions may often be assumed to be a reasonable approximation of their average-for-the-year constant-dollar amount. In that case, no restatement for additions would be necessary.

Recoverable Amount

The Statement requires that constant-dollar amounts of inventory and property, plant and equipment be reduced to the recoverable amount if there has been a material and permanent reduction in the value of the asset to the enterprise.

The definitions and determinations of recoverable amount (net realizable values or value in use, as appropriate) are the same for the constant-dollar basis as for the current-cost basis. The discussion on pages 23 to 25 is also applicable to the constant-dollar supplementary disclosure requirements.

Inventory and Property, Plant and Equipment on a Current-Cost Basis

The Statement requires the disclosure of inventory and property, plant and equipment stated on a current-cost basis as of the end of the current fiscal year.

For purposes of the Statement, the *current-cost* of an asset is the lowest current "buying price or production cost of an asset of *the same age and in the same condition* as the asset owned" (emphasis added). Thus, "current cost" as used in the Statement must not be confused with "replacement cost" as used in the SEC's ASR No. 190. ASR No. 190 defines replacement cost as the lowest cost of obtaining "a new asset of equivalent *operating or productive capability*" (emphasis added).

Current cost data presently do not have to be provided for income-producing real estate properties and unprocessed natural resources.⁷ These assets should be included in the current cost data at their historical amounts as shown in the primary financial statements restated to average-for-the-year constant dollars. If depletion expense is a component of the cost of other inventories, the part of the current cost of those other inventories relating to depletion should be calculated at historical cost similarly restated to constant dollars.

Although the Statement does not require a comprehensive application of current-cost concepts, the information that should be disclosed does require certain amounts based on the current cost of the assets. For inventory, this means the current cost of purchasing the inventory or the current cost of the material, labor, and overhead needed to produce the goods, whichever is applicable in the circumstances of the enterprise. For property, plant and equipment, current cost is the cost of acquiring the same service potential (indicated by operating costs and physical output capacity) as that of assets currently owned. The approach recommended by the Board permits various alternative means of determining current cost.

To determine the supplementary information that is to be disclosed on a current-cost basis, the following steps should be followed:

- Determine the measurement dates of inventory and property, plant and equipment.
- Determine current cost at the measurement dates.
- Adjust the current cost of inventory and property, plant and equipment to recoverable amount, if applicable.

Date of Measurement

The dates of measurement will be:

- The fiscal year-end for all inventory and property, plant and equipment, except that
- The date of use on (or a commitment to) a contract is required for resources used on partly completed contracts.

⁷ The Board has announced its intention to issue a future FASB Statement that will establish standards for the determination of current cost for these assets.

Current Cost of Assets

In determining the current cost of assets, the Statement recognizes the following alternative methods:

- Direct pricing, by using either:
 - current invoice prices
 - vendors' firm price lists or other quotations or estimates
 - standard manufacturing costs that approximate current costs

Example:

Inventory, 12/31/79—as stated in the financial statements	\$12,000
Physical units of inventory, 12/31/79	10,000
Purchase price per unit, 12/31/79— as stated in suppliers' price lists	\$1.25
Inventory, 12/31/79—as stated at current cost (\$1.25 × 10,000)	\$12,500

- Indexing, which involves a revision of historical acquisition cost using either:
 - externally, or independently, generated price indices for the class of assets being considered (including the cost of services that are part of the cost of an asset), or
 - internally generated indices of cost changes for the class of assets being considered (including services).

Example:

Property, plant and equipment, 12/31/79—as stated in the financial statements	\$10,000
Accumulated depreciation, 12/31/79— as stated in the financial statements	\$ 5,000
Specific price index for machinery, 12/31/79	546
Specific price index for machinery (at assumed date of purchase, 1977)	420
Property, plant and equipment, 12/31/79—as stated at current cost ($\$10,000 \times 546 \div 420$)	\$13,000
Accumulated depreciation, 12/31/79—as stated at current cost ($\$13,000 \times 50\%$)	\$ 6,500

Note: This would be the procedure followed for one age group of assets. In a more complex situation, this example might be one line in a schedule of many items in property, plant and equipment.

The existing accounting classifications of assets may provide the basis for initial consideration of the applicability and efficiency of the various estimation methods. That consideration may indicate the desirability of developing other classifications to facilitate the use of more efficient methods. The principal question to be considered for this purpose is whether reasonable current-cost estimates can be developed on some overall or composite basis, or whether current costs must be based on costs of individual units of inventory and property. For many enterprises, a composite basis is likely to be more suitable for some classifications, and an individual basis for others.

If the nature of the units and the existing or readily obtainable asset classifications are such that reasonable estimates can be made on a composite basis, such estimates are likely to be the least costly to make. If estimates are to be based on costs of individual units, estimation sampling ordinarily will provide reasonable estimates at the least cost.⁸

⁸ See discussion on page 20.

For inventories, classifications that may be susceptible of composite estimates include those based on product lines or cost components (raw materials or major commodities, labor, and overhead), or some combination of these elements. Classifications based on volume, unit cost, turnover rates, seasonality, price volatility, or other special characteristics may be useful in some cases, but such matters are likely to be comprehended adequately in the more basic classifications mentioned above or in the cost indices or estimation samples to be used.

For property, plant and equipment, the broadest classification susceptible of composite estimation may be one based on functional units of output capacity. For some enterprises such estimates might be derived from recent installations of facilities, updated to the current date by applying external or internal indices.

If estimates are to be made for physical units, such classifications may be based on the type of construction or usage of buildings and on the kind of processing, production, or service performed by machinery and equipment. If property, plant and equipment is too diverse, or if relevant cost indices are not available, to permit reasonable estimates on a composite basis, estimates based on individual units will be necessary. Depending on the volume, cost and other characteristics of the units, statistical sampling may be practicable in such cases.

Current cost information, in one form or another, is used extensively by most enterprises especially for inventory. Management decisions relating to selling prices, inventory levels, purchasing or manufacturing alternatives, and insurance coverage are normally related to estimated current costs rather than to historical costs.

Current cost and replacement cost probably will be essentially the same for inventories. Therefore, any difficulties in determining current cost under any of the methods permitted by the Statement will be somewhat similar to those already encountered in dealing with SEC replacement cost disclosure requirements.

Direct Pricing

Direct pricing may be used directly for purchased inventory, or, in the case of manufactured items, by applying the current costs of the individual asset components using the enterprise's cost system (standard or otherwise). When direct pricing information is already available, or is readily obtainable, direct pricing may prove to be the best method of estimating current costs because it is relevant and is susceptible to sampling techniques. Any comprehensive explanation of statistical sampling is beyond the scope of this booklet, but the

following general comments are included to facilitate preliminary consideration for planning purposes. If sampling appears to be desirable, the matter should be considered further.

Estimation Sampling

Estimation sampling would provide (1) statistical estimates of current-cost data and (2) measurements of the reasonableness of the estimates expressed in terms of statistical reliability and precision. The reliability and precision would depend generally on the extent of the variation between the historical and current costs of the items sampled, and on the design and size of the sample.

The general approach for a sampling application would be to identify the population of items to be sampled, make preliminary decisions about the sampling reliability and precision desired and an approximation of the variability expected, design the sample, select the sample items, determine the estimated current cost of each sample item, and compute from the sample items the estimated current-cost data for the population and the statistical reliability and precision of the estimate.

The Deloitte Haskins & Sells Auditape System includes estimation sampling design, selection and evaluation programs for performing all of the statistics and computer functions required for sampling applications as outlined above.⁹ Based on the reliability and precision specified for the sample and on known or estimated data about the population, the design program will compute the actual or estimated sample size and the data needed for selecting the sample items. The sample ordinarily will include all population items larger than an upper cut-off amount computed by the program as a part of the sample design. If the population records are or can practicably be made available from computer files, the selection program will select and list the sample items; otherwise, data provided by the design program can be used to select the sample items manually. After the current cost data have been developed for the sample items, the evaluation program will compute the estimate for the population and the reliability and precision of the estimate. The program includes options for use of mean, ratio, or regression estimates; pilot samples; automatic or alternative bases for stratification; selection proportional to size; and other features designed to achieve maximum sampling efficiency.

⁹ The concepts of estimation sampling and the use of the programs described above are included in a book by Maurice S. Newman, a retired partner of Deloitte Haskins & Sells: *Financial Accounting Estimates Through Statistical Sampling by Computer* (John Wiley & Sons, Inc., 1976).

Inventories

The Statement permits inventory stated at FIFO cost to be used as a reasonable measure of current cost, if FIFO cost is adjusted for items that are not stated at current cost. This implies a need for making FIFO cost calculations and adjusting the older FIFO cost layers. In an enterprise with a high inventory turnover rate, the adjustments to FIFO should be minimal. The FIFO cost shortcut may not be appropriate for slow-moving inventories such as agricultural products produced annually (grains, raw sugar, etc.), for items with a long production period (whiskey, wines, ships, etc.) or for inventories whose prices change rapidly.

Property, Plant and Equipment

Direct pricing and unit pricing is more difficult for property, plant and equipment than for inventory. The "current invoice price" or "vendors' firm price lists" should relate to items that are of the same age and in the same condition, and that have the same output potential and operating costs, as the asset owned. Because property, plant and equipment ordinarily consists of used property, and in many cases will include some obsolete items, the relevant direct pricing evidence will have to be obtained from an active market in used assets. Other than for a few types of assets, an active market in used assets would be unusual. Further, some equipment may be so old that used equipment is no longer available, or it has been made obsolete by modern and completely different equipment. Also, some enterprises operate equipment that has been specially designed or built for them, and there is no other similar equipment in existence.

Estimations must be made if direct or unit pricing is to be used. The current cost of a new or used asset similar to the one owned should be obtained and adjusted to recognize the differences in age, operating costs and output potential.

Other Estimation Bases

ASR No. 190 required that any difference in operating costs and output potential between the existing assets and assumed replacements should be included in cost of goods sold. The Statement requires that any such differences be treated as an adjustment to current cost.

In some industries, current costs may be estimated by reference to acquisition costs or quotations for equivalent units of output capacity. In manufacturing, these industries often are characterized

by process-oriented production where the work flows continuously through an integrated production facility. Examples include steel mills, breweries, chemical processing, petroleum refineries, and pulp and paper industries. Nonmanufacturing examples include companies in the electric utility, transportation, communications, hospital care, and hotel industries.

Estimates for functional units in such industries may be based on industry statistics, recent acquisitions or construction by the enterprise, and adjusted for differences in age, operating costs and output potential.

Indexing

Specific-cost indexing has been used extensively for calculating replacement costs for ASR No. 190 purposes. This approach can often simplify considerably the burdens of using more direct methods of pricing to obtain current costs. It will remove many of the difficulties involved in determining the current cost of old, obsolete or one-of-a-kind assets.

In computing current-cost estimates, cost indices would be applied by multiplying historical-cost amounts by the respective ratios of (a) the index for the measurement date or period to (b) the index for the applicable acquisition date or period.

Cost indices may be obtained from external sources or developed internally. External sources include business periodicals, publications of industry associations and government agencies, and computer data banks available through various service organizations. Some companies may be using indices presently for purposes such as complying with ASR No. 190 requirements, accounting for inventory valued on a LIFO basis, revising standard costs, considering sales pricing policies, compiling data for regulatory rate proceedings, or reviewing insurance coverage.

External cost indices have several attributes that make them attractive for estimating current cost. They are relatively inexpensive to obtain and to apply, are available for a relatively wide range of asset classifications, and may be accepted and understood more readily because they are from an independent source. However, the relevance of an index to a particular asset classification should be considered carefully in determining whether its use will provide reasonable estimates of current cost.

A cost index necessarily includes some range of products within the classification from which it is developed, and it will be affected by the mix or weighting of such products. Consequently, the relevance of an index depends largely on the extent to which the product mix used in compiling the index conforms with the mix in the asset classification for which use of the index is being considered. Differences in quality, style or design, productivity, and safety and environmental features should be treated as aspects of the product mix in considering the relevance of an index.

Sources of prominent external indices and of information concerning their content and compilation are included in Appendix E. If an internal index is to be developed, a properly designed statistical sample will provide adequate assurance of the relevance of the index.

Foreign Assets

The Statement does not exempt any inventory or property, plant and equipment outside the United States. Current cost will have to be estimated first in the foreign market, and that cost will then have to be translated into U.S. dollars at the rate in effect at the measurement date (normally fiscal year-end).

If indexing is used to estimate the current cost of foreign assets, care should be taken to ensure that the index used is relevant for that country. It is likely that a different specific index will be needed for each country. In these cases, the original historical costs expressed in nominal foreign currency should first be indexed and the resulting estimated current cost in foreign currency should then be translated into U.S. dollars at the current rate of exchange.

Recoverable Amount

The Statement specifies that assets covered should be stated at current cost or lower recoverable amount, if applicable. However, a measure lower than current cost is only appropriate if there has been a material and permanent reduction in the value of the asset to the enterprise.

When the asset concerned is about to be sold, as is the normal case for inventories, the applicable value, if permanently lower than current cost, is "net realizable value." When immediate sale of the asset is not intended, as is the normal case for property, plant and equipment, the applicable measure, if permanently lower, is "value in use."

The Statement defines these two concepts in the following way:

- “*Net realizable value* is the amount of cash, or its equivalent, expected to be derived from sale of an asset, net of costs required to be incurred as a result of the sale.”
- “*Value in use* is the net present value of future cash flows (including the ultimate proceeds of disposal) expected to be derived from the use of an asset in an enterprise.”

The definition of net realizable value is similar to that used in Accounting Research Bulletin No. 43, *Restatement and Revision of Accounting Research Bulletins*, Chapter 4, and computing it should require no additional work, because enterprises already have to compute this value to comply with the “lower of cost or market” rule in their primary financial statements. For purposes of the Statement disclosures, net realizable value is essentially the same as that used to comply with the requirements of ARB No. 43, FASB Statement No. 8, and other authoritative pronouncements, although there are some differences.

The theory underlying value in use is identical to that underlying net realizable value. If the expected future cash flows to be generated by use and ultimate disposal of the asset, discounted at the cost of capital to the enterprise after allowing for the risk of the activities concerned does not exceed current cost, the cash flow potential of the asset has been impaired. If that impairment is permanent, it should be recognized as a reduction in the current cost of the asset.

In practice, it is almost impossible to estimate the future cash flow to be derived from an item or individual unit of property, plant or equipment that is a part of a complex, interrelated system of manufacturing or distributing a number of products. The Statement indicates that in these cases value in use should be estimated for the group of assets in total. The types of estimates to be made are similar to those used by management when it is considering whether a particular machine should be replaced or whether a segment should be discontinued because it is no longer economically justified.

Overall tests may be acceptable, and budgets or forecasts based on current (not historical) costs could be used as a measure of the fact that future cash flow exceeds current costs. In those cases where budgets or forecasts indicate that future cash flow will be less than current costs, a more careful determination of net realizable value

(if the enterprise decides to sell the asset) or value in use (if it cannot or will not sell the asset) is required. Some possible examples of enterprise situations where an adjustment to value in use may be required are:

- An enterprise has an inefficient plant that has been almost totally depreciated but is still in use. (In this case, historical-cost depreciation is negligible, and the plant may still be marginally competitive because it has low fixed costs.)
- A transportation company must maintain an unprofitable route because of regulatory requirements.
- A rate-regulated utility has plants for which the regulating body will allow only historical-cost depreciation to be included in the rates.
- A foreign subsidiary operates plants under government price controls that do not recognize replacement-cost pricing for sales.

Income from Continuing Operations on a Constant-Dollar Basis

The Statement defines income from continuing operations as income after applicable income taxes, less:

- The results of discontinued operations
- Extraordinary items
- The cumulative effect of accounting changes

The Statement requires that income from continuing operations be restated in dollars having a purchasing power equal to the average purchasing power of the dollar over the year. The CPI-U is the applicable measure of changes in the general level of prices.

Application

In a comprehensive application of constant-dollar accounting, all income statement amounts would be restated on a constant-dollar basis. The Statement, however, limits the constant-dollar restatement requirements to the cost of goods sold and depreciation expense components of income from continuing operations. These are discussed below.

Historical cost may be used as a reasonable approximation of constant-dollar amounts for all other components of income from continuing operations. However, if inflation rates or operations are

markedly seasonal, a better estimate may be required. Under these circumstances, a more accurate result is obtained by dividing income, expenses, gains and losses into quarterly or monthly periods, multiplying each historical-cost amount by the average-for-the-year CPI-U and dividing the result by the average-for-the-period CPI-U.

If the value of inventory or property, plant and equipment is impaired during the year, and it is necessary to reduce the constant-dollar amounts of the assets to lower recoverable amounts, that reduction must be deducted in determining constant-dollar income from continuing operations.

A comprehensive application of constant-dollar accounting would require separate restatement of all income and expense items related to nonmonetary assets and liabilities such as:

- Gain or loss on sale of property, plant and equipment
- Gain or loss on sale of securities
- Amortization of prepaid expenses, deferred charges and other intangibles
- Changes in deferred income

Computation of Income from Continuing Operations—Constant-Dollar Method

Constant-dollar income from continuing operations is derived as follows:

- Historical income from continuing operations
- Deduct the excess of constant-dollar cost of goods sold over the historical cost of goods sold
- Deduct the excess of constant-dollar depreciation expense over the historical depreciation expense
- Deduct the excess, if any, of the constant-dollar amount of assets over recoverable amount, for assets that have been reduced to lower recoverable amounts during the year

An example of this computation is included in Appendix A. 1.

Cost of Goods Sold

The general restatement rule should be applied to historical cost of goods sold. This would require determining the date of acquisition of

each item sold. As this is difficult, the following method may be used:

- Roll forward the prior year's ending inventory. Beginning inventory for the year, as restated in average-for-the-prior-year constant dollars, is rolled forward to restate it in average-for-the-current-year constant dollars.
- Add purchases of inventory, manufacturing costs and overhead, restated in average-for-the-year constant dollars. The general rule is to be applied for this restatement, although quarterly averages may be used. In many cases, the historical amounts of additions can be considered a reasonable approximation of average-for-the-year constant dollars. If manufacturing costs or overhead include depreciation, the restatement of depreciation in average-for-the-year constant dollars should be based on the restatement of property, plant and equipment.
- Deduct year-end inventory as restated in average-for-the-year constant dollars.

The resulting figure is an estimate of cost of goods sold expressed in average-for-the-year constant dollars.

Example:

Average-for-the-year CPI-U			217
Measurement-date (date of purchase, fourth quarter 1978) CPI-U			202
Measurement-date (date of purchase, fourth quarter 1979) CPI-U			227
	<u>As Stated in the Financial Statements</u>	<u>Conversion Factor</u>	<u>As Stated in Average 1979 Dollars</u>
Inventory, 1/1/79	\$ 8,000	$217 \div 202$	\$ 8,594
Purchases	<u>44,000</u>	$217 \div 217$	<u>44,000</u>
	52,000		52,594
Inventory, 12/31/79	<u>12,000</u>	$217 \div 227$	<u>11,471</u>
Cost of goods sold	<u><u>\$40,000</u></u>		<u><u>\$41,123</u></u>

Another simplification relates to nonmonetary items included in manufacturing expense or overhead that were acquired prior to their use and were not classified as inventory in the primary financial statements. The above method assumes that these assets were acquired at the time they are transferred to inventory or expense and, as a result, cost of goods sold will be understated. These types of assets are usually not significant and the effect on cost of goods sold usually is not material.

Depreciation Expense

Depreciation expense for the year stated in average-for-the-year constant dollars should be computed by applying the depreciation rates used in determining the historical cost depreciation to the average-for-the-year constant-dollar amount of property, plant and equipment.

Example:

Property, plant and equipment—as stated in average 1979 constant dollars	\$11,923
Depreciation rate	20%
Depreciation expense—as stated in average 1979 constant dollars ($\$11,923 \times 20\%$)	\$ 2,385

Constant-dollar depreciation expense for the year should be allocated to assets, cost of goods sold, and other components of income from continuing operations in the same manner that historical-cost depreciation expense is allocated to those items.

Foreign Operations

Income statement information for foreign subsidiaries, branches and other investees that is stated in foreign currency must first be translated into U.S. dollars in accordance with FASB Statement No. 8. Of these, the only amounts that need to be restated to average-for-the-year constant dollars are cost of goods sold and depreciation expense included in the consolidated primary financial statements. For these amounts, the approaches outlined in the preceding paragraphs should be used to restate the translated U.S. dollar amounts.

Income from Continuing Operations on a Current-Cost Basis

Current-cost income from continuing operations may be computed by making the following two adjustments to the historical cost amounts reported in the primary financial statements:

- Deduct the excess of current cost of goods sold over historical cost of goods sold.
- Deduct the excess of current-cost depreciation expense over the historical-cost depreciation expense (excluding any depreciation expense allocated to cost of goods sold).

Sales may be assumed to have occurred evenly throughout the fiscal year unless there are strong seasonal patterns in prices or volume of sales. Even where seasonal patterns exist, the uniformity assumption for a shorter period, such as a quarter, may be appropriate. This assumption is especially useful if an enterprise uses indexing to determine current costs.

The Statement requires that the income tax expense and foreign currency gains and losses are to be treated as components of income from continuing operations, and are not to be adjusted in calculating current-cost income from continuing operations.

Increases or decreases in the current costs of inventory and property, plant and equipment, net of general inflation and changes in specific prices are not to be included in current cost income from continuing operations.

Cost of Goods Sold

The Statement requires that cost of goods sold be computed at current cost, or lower recoverable amount, at the date of each sale or at the date on which resources are used on or committed to a specific contract. The basic method of computing the current cost of goods sold is the same as for computing current cost of inventories. However, direct pricing of goods sold to determine current cost is more difficult to apply, because it is necessary to calculate the cost at different dates during the year.

Example:

Cost of goods sold—as stated in the financial statements	\$40,000
Number of items sold	40,000
Weighted average purchase price — as shown by supplier's price lists	\$1.05
Cost of goods sold—as stated at current cost ($\$1.05 \times 40,000$)	\$42,000

Note: LIFO cost of goods sold usually may be used as a reasonable approximation of current cost of goods sold, except when LIFO cost layers are invaded or if turnover is slow.

Satisfactory estimates of the current cost of goods sold ordinarily cannot be derived solely from the current cost of inventories at the end of the year, for the following reasons. First, the mix of products included in sales and in inventory may differ. Second, the level of current cost and the ratio of such cost to historical cost may change during the year. Consequently, the cost indices or statistical samples used to estimate current cost of goods sold should be applied throughout the year.

Recognizing the difficulties involved, the Statement permits a simplification: Historical cost of goods sold computed on a LIFO (last-in, first-out) basis is normally assumed to provide a reasonable estimate of current cost of goods sold if it is adjusted for the liquidation of layers that are not stated at approximate current costs.

If cost of goods sold includes any depletion expense related to unprocessed natural resources, it is not necessary to estimate the current cost of such depletion. The Statement indicates that the portion of current cost of goods sold relating to depletion can be stated at historical cost adjusted to average-for-the-year constant dollars by applying a general or specific price index.

In manufacturing enterprises, cost of goods sold normally includes a portion of the depreciation expense. In such cases current-cost depreciation expense should be allocated to cost of goods sold in computing current cost unless current-cost cost of goods sold is not determined by components but on an overall basis such as indexing or net realizable value.

Current cost of cost of goods sold must be reduced to net realizable value at the date of sale if net realizable value is lower than current cost. Because the selling price is the net realizable value, this rule need only be considered when selling price is less than current cost. Because this is unlikely where direct pricing methods are used for determining current cost, the net realizable value rule generally is limited to situations where indexing is used to determine current cost.

Depreciation Expense

Current cost depreciation expense must be based on the average of the current cost of property, plant and equipment for the year, or lower appropriate value.

Example:

Net property, plant and equipment:	
At current cost, 12/31/78	\$10,300
At current cost, 12/31/79	\$ 6,500
Average at current cost—during 1979	\$ 8,400
Remaining useful life at 12/31/78	3.5 years
Depreciation expense—as stated at current cost ($\$8,400 \div 3.5$)	\$ 2,400

In general, it will be necessary to compute current cost (or lower value in use, if applicable) of property, plant and equipment only at the beginning and end of the fiscal year and compute depreciation expense for the year on the resulting average figure. As discussed previously, however, if the normal method and rates of depreciation have been chosen to offset in part the effects of inflation, alternate methods or rates can be used to compute current-cost depreciation expense.

Enterprises under rate regulations or other price controls that have reduced the current cost of property, plant and equipment to value in use should compute depreciation based on the current cost, unless the enterprise would not undertake replacement, if necessary, under the present conditions.

Current-cost depreciation expense relating to income-producing real estate properties and unprocessed natural resources need not be calculated. Depreciation expense for these assets should be computed on historical costs and restated to constant dollars by applying a general or specific price index.

Purchasing Power Gain or Loss on Net Monetary Items

The Statement calls for the separate disclosure of the amount of purchasing power gain or loss on net monetary items. Typical monetary and nonmonetary items are shown in Appendix D.

An enterprise that holds net monetary assets in an *inflationary* period suffers a loss in the purchasing power of those assets during the period. Likewise, an enterprise with net monetary liabilities has a gain because the amount required to satisfy the net liability, expressed in purchasing power, decreases with inflation. In a *deflationary* period, the effects are reversed.

The purchasing power gain or loss on net monetary items requires the calculation of the effect of inflation on the outstanding balances of net monetary items during the year. The balance is modified with each transaction that affects a monetary item. An exact computation would be too onerous because most of the transactions of an enterprise affect monetary items. Therefore, monthly, quarterly or annual averages may be used, as appropriate, to achieve reasonable results.

After identifying all monetary items, opening and ending balances and net changes should be computed at historical costs. Net changes may be computed on a monthly, quarterly or annual basis by comparing beginning and ending balances for each period.

The following restatements to average-for-the-year constant dollars should then be made:

- Year-end balance of net monetary items at historical cost, multiplied by the average-for-the-year CPI-U, and the result divided by the end-of-the-current-year CPI-U.
- Net changes (increases or decreases) in monetary items at historical cost, multiplied by the average-for-the-year CPI-U and the result divided by the CPI-U of the date or period of change. If changes in monetary items are assumed to have occurred evenly throughout the year, the historical cost net change for the year can be assumed to be a reasonable approximation of average-for-the-year constant dollars net change, and no restatement of the net changes amount is needed.
- Beginning-of-the-year balance of net monetary items at historical cost, multiplied by the average-for-the-current-year CPI-U, and the result divided by the end-of-the-prior-year CPI-U.

The amount of purchasing power gain or loss on net monetary items for the year, stated in average-for-the-year constant dollars, is calculated by adding the year-end balance and any decreases, and deducting the beginning of the year balance and any increases, all as restated in average-for-the-current-year dollars.

Example:

Average-for-the-year CPI-U			217
Beginning-of-the-year (12/78) CPI-U			203
End-of-the-year (12/79) CPI-U			229
	<u>As Stated in the Financial Statements</u>	<u>Conversion Factor</u>	<u>As Stated in Average 1979 Dollars</u>
Net monetary assets, 1/1/79	\$4,000	$217 \div 203$	\$4,276
Annual increase	250	$217 \div 217$	<u>250</u>
			4,526
Net monetary assets, 12/31/79	4,250	$217 \div 229$	<u>(4,027)</u>
Purchasing power loss on net monetary items			<u>\$ 499</u>

Note: Increase may be computed monthly or quarterly.

Increases or Decreases in the Current Costs of Inventory and Property, Plant and Equipment Held During the Period (Holding Gains or Losses), Net of Inflation

Increases or decreases in the current costs of inventory and property, plant and equipment held during the period are increases or decreases between the start of the period (or date of acquisition, if later) and the end of the period (or the date of realization, if earlier). These increases or decreases are commonly known as holding gains or losses. The holding gains or losses on inventory and prop-

erty, plant and equipment, before excluding the effect of inflation, may be computed as follows:

- Ending balance of inventory and property, plant and equipment (net of accumulated depreciation) measured at current cost at the end of the year (or lower appropriate value, i.e., net realizable value or value in use)
- Add cost of goods sold at current cost (or lower appropriate value) at the date of sale
- Add net amounts realized on disposals of property, plant and equipment
- Add current-cost depreciation expense
- Deduct acquisitions and production at historical costs which are assumed to be current costs at the time incurred
- Deduct beginning balance of inventory and property, plant and equipment (net of accumulated depreciation) measured at current cost at the beginning of the year (or lower appropriate value)

The resulting amount measures the increase or decrease in the current cost of inventory and property, plant and equipment held during the period due to changes in the current cost of those assets.

The Statement requires that this holding gain or loss amount be adjusted to eliminate the effect of the general inflation as measured by changes in prices as represented by the CPI-U; this adjustment is called the "inflation adjustment."

The inflation adjustment is calculated by determining the increase in current costs that would have resulted if the prices of the assets had changed in the same magnitude and direction as the general prices measured by the CPI-U. The inflation adjustment is applied to the nominal increase or decrease in the current cost of inventory and property, plant and equipment held during the period. The result is a holding gain or loss net of inflation.

Holding gains or losses, net of inflation, may be calculated by restating *each component* of the total increase or decrease computation in average-for-the-year constant dollars, as follows:

- Ending balance at end-of-the-year current cost is multiplied by the average-for-the-year CPI-U and the result divided by the end-of-the-current-year CPI-U.
- Cost of goods sold is multiplied by the average-for-the-year CPI-U and divided by the CPI-U at the date of sale. A reasonable approximation may result if the quarterly or monthly average CPI-U is used as the divisor for quarterly or monthly acquisitions, respectively.
- Net amounts realized on disposals are restated in the same way as is cost of goods sold.
- Depreciation expense is multiplied by the average-for-the-year CPI-U and divided by the average CPI-U of the depreciation period (month, quarter or year).
- Acquisitions and production expenses are multiplied by the average-for-the-year CPI-U and divided by the CPI-U at the date of acquisition. Annual, quarterly or monthly averages may be used for these components.
- Beginning balance at beginning-of-the-year current cost is multiplied by the average-for-the-current-year CPI-U and divided by the beginning-of-the-year CPI-U.

The amount that results from adding the ending balance, cost of goods sold, amounts realized on disposals and depreciation expense and deducting acquisitions, production, and beginning balance is the increase or decrease in the current cost of inventory and property, plant and equipment, net of general inflation. The amount is a measure of the additional increase or decrease in asset value that resulted from the enterprise's holding specific assets instead of the "market basket" of goods and services included in deriving the CPI-U. (For a discussion of the construction of the CPI-U, see Appendix E.1.)

Example:

Balances, 1/1/79—at current cost:			
Inventory			\$ 9,000
Property, plant and equipment, net			10,300
Balances, 12/31/79—at current cost:			
Inventory			12,500
Property, plant and equipment, net			6,500
Average-for-the-year CPI-U			217
Beginning-of-the-year (12/78) CPI-U			203
End-of-the-year (12/79) CPI-U			229
	As Stated at Current Cost	Conversion Factor	As Stated in Average 1979 Dollars
Balance, 12/31/79	\$19,000	$217 \div 229$	\$18,004
Cost of goods sold	42,000	$217 \div 217$	42,000
Disposals	—		—
Depreciation expense	2,400	$217 \div 217$	2,400
Acquisitions and production expenses	(44,000)	$217 \div 217$	(44,000)
Balance, 1/1/79	<u>(19,300)</u>	$217 \div 203$	<u>(20,631)</u>
Holding gain	<u>\$ 100</u>		
Holding loss, net of general inflation			<u>\$ 2,227</u>

A reasonable simplification, if there are no major fluctuations in the level of inflation or the volume of transactions during the year, is to consider that all current amounts of acquisitions and dispositions, as stated, are reasonable approximations of average-for-the-year current-cost amounts. Beginning and end of year balances, however, would have to be determined on a current-cost basis.

The required disclosures relating to the increases or decreases in the current cost of inventory and property, plant and equipment held during the period (gross and net of inflation) must be excluded from income from continuing operations.

There has been considerable discussion as to whether or not the increase in current costs of assets held (holding gains) should be considered to be income. The Statement indicates that the increase or decrease in the current cost of assets held during the year should be reported separately and not as a part of income from continuing operations. The Statement, however, does consider the increase or decrease in the current cost of assets held during the year to be an increase or decrease in shareholders' equity (net assets).

For purposes of complying with the provisions of the Statement, holding gains or losses are segregated between those that are realized and those that are unrealized. Realized gains are those relating to assets sold or consumed during the year and are treated as adjustments to income from continuing operations to remove their effects from such income. The adjustment to cost of goods sold is the total increase in the current cost of the inventory sold, from the date of purchase to the date of sale. The adjustment to depreciation expense is the portion of the total increase in current cost of property, plant and equipment (from the date of acquisition to the date of use) that relates to the portion of the historical cost that is allocated to income during the year.

Unrealized gains are those that relate to assets held at year-end (inventory and net property, plant and equipment). They are the total increase in the current cost of those assets from the date they were acquired to the end of the current year.

The increase or decrease in the current cost of inventory and property, plant and equipment held during the year, reported as holding gains or losses in accordance with the requirements of the Statement, consists of:

- The holding gains or losses realized during the year, and
- The change in unrealized holding gains or losses between the beginning and end of the year.

Example:

	<i>As Stated in the Financial Statements</i>	<i>As Stated at Current Cost</i>	<i>Difference</i>
Inventory, 1/1/79	\$ 8,000	\$ 9,000	\$1,000
Inventory, 12/31/79	12,000	12,500	500
Cost of goods sold	40,000	42,000	2,000
Purchases	44,000	44,000	—
Property, plant and equipment, 1/1/79	7,000	10,300	3,300
Property, plant and equipment, 12/31/79	5,000	6,500	1,500
Depreciation expense	2,000	2,400	400
	<i>Inventory</i>	<i>Property, Plant and Equipment</i>	<i>Total</i>
Unrealized gains:			
At 12/31/79	\$ 500	\$1,500	\$2,000
At 1/1/79	<u>1,000</u>	<u>3,300</u>	<u>4,300</u>
Increase (decrease) in unrealized gains	(500)	(1,800)	(2,300)
Realized gains	<u>2,000</u>	<u>400</u>	<u>2,400</u>
Increase (decrease) in current cost of assets held during the year	<u>\$1,500</u>	<u>(\$1,400)</u>	<u>\$ 100</u>

After eliminating the effects of general inflation (by restating all historical-cost and current-cost amounts in average-for-the-current-year constant dollars), the holding gain or loss is the effect of the differences between the changes in the current cost of the assets held during the year and the changes in the general level of prices. If during the year the specific prices of the assets held increased more than the general level of prices, the enterprise will show a holding gain, net of inflation. If instead, the general level of prices increased more than the specific prices of the assets held, the enterprise will show a holding loss, net of inflation.

These net holding gains or losses may also be expressed as:

- The holding gains or losses, net of inflation, realized during the year, and
- The change in unrealized holding gains or losses, net of inflation, between the beginning and end of the year.

Example:

	<i>Historical Costs as Adjusted for General Inflation</i>	<i>Current Costs as Adjusted for General Inflation</i>	<i>Difference</i>
Inventory, 1/1/79	\$ 8,594	\$ 9,621	\$1,027
Inventory, 12/31/79	11,471	11,845	374
Cost of goods sold	41,123	42,000	877
Purchases	44,000	44,000	—
Property, plant and equipment, 1/1/79	8,346	11,010	2,664
Property plant and equipment, 12/31/79	5,961	6,159	198
Depreciation expense	2,385	2,400	15
	<u><i>Inventory</i></u>	<u><i>Property, Plant and Equipment</i></u>	<u><i>Total</i></u>
Unrealized gains, adjusted for general inflation:			
At 12/31/79	\$ 374	\$ 198	\$ 572
At 1/1/79	<u>1,027</u>	<u>2,664</u>	<u>3,691</u>
Increase (decrease) in unrealized gains, adjusted for general inflation	(653)	(2,466)	(3,119)
Realized gains, adjusted for general inflation	<u>877</u>	<u>15</u>	<u>892</u>
Increase (decrease) in current cost of assets held during the year, net of changes in the general price level	<u>\$ 224</u>	<u>(\$2,451)</u>	<u>(\$2,227)</u>

Basis for Five-Year Summary Amounts

To ensure comparability, all information included in the five-year summary must be expressed in constant dollars having the same purchasing power. The enterprise may choose to report in average-for-the-current-year constant dollars, which is the basis used for the one-year supplementary information, or in base-year (1967 CPI-U = 100) constant dollars.

If average-for-the-current-year constant dollars are used, the information developed for prior years (which had been restated in average-for-the-prior-year constant dollars) must be rolled forward. This is done by multiplying the prior year's amounts by the average-for-the-current-year CPI-U, and dividing the results by the average-for-the-prior-year CPI-U. Furthermore, it will be necessary to roll forward prior-period amounts each year.

Example:

Average 1979 CPI-U						217
Average 1978 CPI-U						195
Conversion Factor ($217 \div 195$)						1.1128
	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	
Net sales, in average 1978 dollars	\$62,981	\$61,579	\$61,072	\$58,000	—	
Conversion factor	1.1128	1.1128	1.1128	1.1128	—	
Net sales, in average 1979 dollars	\$70,087	\$68,526	\$67,962	\$64,544	\$60,000	

The advantage of using this method is that the one-year and five-year data are reported in the same constant dollars, and that the purchasing power of the average-for-the-current-year dollar may be more familiar to users of the financial statements.

If base-year constant dollars are used, the information developed for the current year (which has been restated in average-for-the-current-year constant dollars) must be rolled back. This is done by multiplying current-year amounts by the base-year CPI-U (100) and dividing

the result by the average-for-the-current-year CPI-U. Current year data only need to be rolled back. Prior period information is already restated in base-year constant dollars, and does not need to be restated again, unless the Bureau of Labor Statistics changes the base-year for the CPI-U.

Example:

Average 1979 CPI-U						217
Base-year (average 1967) CPI-U						100
Conversion factor ($100 \div 217$)						.4608
	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	
Net sales, in base-year dollars	\$32,298	\$31,579	\$31,319	\$29,744	—	
Net sales, in average 1979 dollars						\$60,000
Conversion factor						.4608
Net sales, in base-year dollars	\$32,298	\$31,579	\$31,319	\$29,744	\$27,650	

The advantage of using this method is that the data reported in the five-year summary are not changed each year. Also, comparisons can be made with prior year's data over time and trends and ratios can be more easily maintained and presented. However, the current year's information will be expressed in different constant dollars in the one-year and five-year summaries. Also, users may not be familiar with or attach as much significance to the purchasing power of the base-year dollar.

It is important to analyze carefully all the data to be included in the five-year summary to ascertain that both current-cost and constant-dollar data are expressed in the same constant dollars (whether average-for-the-year or base-period). The dating of dollars is a new idea for many preparers and users of financial statements, and special efforts must be made to identify clearly the unit of measurement being used in reporting each item in the supplementary disclosures in order to minimize confusion. Care also must be exercised in comparing results derived from using different bases because in most situations they will not be comparable.

Net Assets at Fiscal Year End

The Statement requires the disclosure of net assets as of the end of each of the last five fiscal years expressed on both a current-cost basis and a constant-dollar basis. However, to determine the required amounts, only the impact on inventory and property, plant and equipment needs to be considered. Inflation adjustments for all other nonmonetary items are not required. The resulting constant-dollar or current-cost net assets as of the end of each year must be stated in average-for-the-current-year or base-period constant dollars.

To determine the required amounts for each of the last five years on each basis, the following adjustments must be made:

- **Constant-dollar basis.** Add (deduct) the excess of end-of-the-current-year constant-dollar amounts over historical costs at year-end of inventory and property, plant and equipment to the amount of net assets (stockholders' equity) at year-end as reported in the financial statements. Roll back the resulting amounts to average-for-the-current-year (or base-period, if elected) dollars.
- **Current-cost basis.** Add (deduct) the excess of current cost over historical cost of inventory and property, plant and equipment at year-end to the amount of net assets (stockholders' equity) at year-end as reported in the primary financial statements. Roll back the resulting amounts to average-for-the-current-year (or base-period, if elected) dollars.

An enterprise may elect to report as supplementary information the amounts resulting from a comprehensive restatement of its financial statements using either the current-cost/constant-dollar method, or the historical-cost/constant-dollar method; or both. In that case, the enterprise may report the amount of net assets in the five-year summary that results from such comprehensive restatement. If amounts obtained through comprehensive restatement are reported, that fact must be disclosed in the explanatory notes.

Example of Constant-Dollar Basis:

Average 1979 CPI-U			217
Average 1977 CPI-U			182
End-of-the-year (12/79) CPI-U			229
Fourth Quarter 1979 CPI-U			227
	As Stated in the Financial Statements	Conversion Factor	As Stated in Year-End Constant Dollars
Inventory	\$12,000	$229 \div 227$	\$12,106
Property, plant and equipment	10,000	$229 \div 182$	12,582
Accumulated depreciation	(5,000)	$(50\% \times 12,582)$	(6,291)
	<u>\$17,000</u>		<u>\$18,397</u>
Net assets (stockholders' equity), 12/31/79— as stated in the financial statements			\$26,250
Inventory and property, plant and equipment, net:			
Year-end constant dollar amount		\$18,397	
Financial statement amount		<u>17,000</u>	<u>1,397</u>
Net assets, 12/31/79—as stated in year-end constant dollars			<u>\$27,647</u>
Multiply by conversion factor			$217 \div 229$
Net assets, 12/31/79—as stated in average 1979 constant dollars			<u>\$26,198</u>

Example of Current-Cost Basis:

Average 1979 CPI-U		217
End-of-the-year (12/79) CPI-U		229
	As Stated in the Financial Statements	As Stated at Current Cost
Inventory	\$12,000	\$12,500
Property, plant and equipment, net	5,000	6,500
	<u>\$17,000</u>	<u>\$19,000</u>
Net assets (stockholders' equity), 12/31/79—as stated in the financial statements		\$26,250
Inventory and property, plant and equipment, net:		
Current-cost amounts	\$19,000	
Financial statement amounts	<u>17,000</u>	<u>2,000</u>
Net assets, 12/31/79— as stated at current cost		<u>\$28,250</u>
Conversion factor		217 ÷ 229
Net assets, 12/31/79—as stated at current cost in average-for-the-year dollars		<u>\$26,770</u>

Per-Share Data

The provisions of APB Opinion No. 15, *Earnings Per Share*, should be followed in computing the required per-share supplementary information. Accordingly, the number of shares used to compute the supplementary per-share data should be the same as that used to compute per-share data for the primary financial statements.

The Statement does not indicate that supplementary per-share data should be presented on both a primary basis and a fully diluted basis. The staff of the FASB has indicated that, as a minimum, primary per share data should be disclosed, although additional disclosure on a fully diluted basis is encouraged.

Income from continuing operations, both at current cost and in constant dollars, as computed, is stated in average-for-the-year constant dollars. These amounts divided by the number of shares used to compute per-share data for the primary financial statements will give the income per share data in average-for-the-current-year constant dollars.

Comparative per-share amounts for the prior years have to be restated in average-for-the-current-year constant dollars. If the base-year method is elected, the current-year data would need to be rolled back to be consistent with the data for the prior four years by multiplying them by the base year CPI-U and dividing by the average-for-the-current-year CPI-U.

Cash dividends declared must be restated in average-for-the-year constant dollars by multiplying the amounts declared per share by the average-for-the-year CPI-U and dividing the result by the CPI-U for the date each dividend was declared. If dividends are declared evenly throughout the year, historical amounts should be reasonable approximations of average-for-the-current-year constant dollars. If base-year presentation is chosen, the current-year amount should be rolled back to base-year constant dollars.

The market price per common share at year end is expressed in year-end dollars and must be rolled back to average-for-the-year dollars (or base-period dollars) by multiplying the market price per common share by the average-for-the-year (or base-period) CPI-U and dividing the result by the end-of-the-current-year CPI-U.

Examples of per-share disclosures are given in Appendix A.

Notes to the Supplementary Information

In its notes to the supplementary information, the enterprise must include, as a minimum, the following:

- The principal types of information used to calculate current cost of inventory, property, plant and equipment, cost of goods sold and depreciation expense.
- The reasons for omitting current-cost information for the current fiscal year, when and if omitted, because current-cost and constant-dollar data are not materially different.
- The average level of the CPI-U (or the year-end CPI-U, if comprehensive restatement is used) for each year included in the five-year summary.
- The differences, if any, in the depreciation methods and the estimates of useful lives and salvage values used in computing current-cost or constant-dollar depreciation expense from those used in computing historical-cost depreciation expense.
- The aggregate amount of current-cost and constant-dollar depreciation expense, if such expense is allocated among various amounts reported in the supplementary disclosures.
- A statement that historical income tax expense has not been modified for any timing differences, allocations or other adjustments that may result from applying the current-cost or constant-dollar bases in preparing the supplementary information.

Additional information may be included in the notes, and the Statement encourages such additional disclosure.

Some Precautions

The Statement recognizes that data prepared on single measurement bases seldom fulfill the sometimes conflicting requirements of users of financial information. The supplementary data provided are only experimental; there is as yet insufficient evidence to indicate which, if any, of the different supplementary disclosures fulfills the varying needs of users of financial statements.

In requiring supplementary information on both a current-cost and constant-dollar basis the FASB is asking for information that is not available in historical-cost financial statements. However, there is little experience in the development and use of this type of information; highlighting some of the precautions that should be exercised by preparers and users of financial reports may be helpful.

The disclosure of at least three different amounts for income and net assets (historical, constant dollar and current cost) will undoubtedly confuse many users. Commentators and analysts should be careful to avoid choosing the amounts that best prove their contentions, ignoring conflicting evidence in the other disclosures. Preparers of financial statements should be careful to explain the meaning and usefulness of each measure, and attempt to give reasonable explanations for the differences among them.

The Statement allows considerable leeway in using estimates and shortcuts in determining the supplementary data. It also circumvents many potential concerns by providing for simplifications, such as not adjusting or allocating income taxes, arbitrarily defining some items as monetary items, and excluding adjustments of certain income derived from nonmonetary assets. In some cases, this will result in supplementary data that are significantly different from those computed on the basis of comprehensive applications of current-cost or constant-dollar accounting for the same enterprise. In choosing the estimates and shortcuts that are to be used, each enterprise should try to minimize potential distortions. However, the effects of distortions should be measured against the costs of applying more precise methods.

A significant degree of subjectivity and imprecision is inherent in the determination of current costs. Because of the many alternatives for determining current costs permitted by the Statement, income management may result. Caution should be exercised in determining and using current-cost amounts so that those amounts are as verifiable and realistic as practicable.

Under ASR No. 190, indexing was used considerably. Presumably specific indices also will be used to determine current costs under the Statement. The relevance and reliability of the indices should be analyzed and tested.

The Statement uses annual averages extensively. In many cases, historical-dollar amounts are assumed to be reasonable approximations of average-for-the-year dollar amounts. This is, in effect, the same as using an annual average. This approach assumes that neither the rates of inflation nor the enterprise's activities fluctuate markedly over the year. If fluctuations are significant (as for instance in such seasonal activities as agriculture, apparel and tourism), the use of monthly or quarterly averages may materially affect results. The benefits to be derived from using monthly, quarterly or annual averages, and the related costs, should be carefully considered.

Questions and Answers

The following are some questions that have been raised by commentators during the Board's due-process procedures. Although some of these questions are answered in the Statement, they are given here for ready reference. As the provisions of the Statement are applied in specific cases or industries, a number of unforeseen issues will arise.

Question. What adjustments should be made when the Consumer Price Index is modified?

Answer. One of the FASB's reasons for choosing the CPI-U instead of the GNP Implicit Deflator as the index to be used is that the GNP Implicit Deflator is revised frequently, but the CPI-U is not.

The only modification presently envisioned is a change in the base-year of the CPI-U from 1967 to some subsequent date. If that occurs, all information in the five-year summary that was stated in base-year dollars would have to be rolled forward to the new base-year.

Question. If the CPI-U for a current period is not available in time for the preparation of the annual report, which index should be used?

Answer. The indices for the last several months of a fiscal period, if unavailable, may be *estimated* by extrapolating the change from the previous year and by taking into consideration any other available information. Also, the mid-year index often may be used as a reasonable approximation of the average-for-the-year index.

Question. If depreciation of an enterprise's property, plant and equipment has no significant effect on income or net assets (such as in a bank), should current costs be computed?

Answer. As in all pronouncements of the FASB, the provisions of the Statement need not be applied to immaterial items. However, the materiality measures applied should be based on the current-cost relationships and not only on the historical-cost relationships.

Question. Is the current cost of fully depreciated assets required to be calculated and disclosed?

Answer. If the methods of depreciation and estimates of useful lives and salvage values of assets used in the primary financial statements have not been chosen to offset inflation in whole or in part, calculation of the current cost of fully depreciated assets is not necessary. In that situation there would be no change in the

estimates used to determine depreciation, the useful life of the asset would have expired for current-cost purposes as well as for historical cost purposes, and the asset would be valued at estimated salvage value, if any.

Although a change of method or estimates may be justified because the historical bases included an allowance for inflation, no estimation of current cost is necessary for fully depreciated assets unless the change includes a change in useful life.

Question. In computing value in use, what discount rate should be used to discount future cash flow?

Answer. The Statement indicates that an appropriate rate that allows for the risks involved should be used. In the Exposure Drafts, the FASB indicated that an appropriate rate might be the minimum return on the capital of the enterprise after taking into consideration the risks (risks in estimating quantities, political risk, price change risks, etc.), the estimated future inflation (if the estimated future cash flow includes the effects of inflation) and the impact of taxation.

Different discount rates may be used for groups of assets having different risks.

Question. What are the effects on the supplementary information of changes in the estimates of depreciable lives or residual values of assets?

Answer. Any change in the basis of preparing the historical statements that is not the direct result of inflation considerations should be applied in preparing the supplementary information. Changes in accounting estimates and corrections of errors in the historical statements should be included in the supplementary data.

Question. The historical-cost income statement may contain a substantial amount of repair and maintenance expense. Should current-cost depreciation be adjusted to allow for this expense?

Answer. If the current cost is based on an asset in the same condition as the one owned, the asset will require the same amount of repairs and maintenance to operate at the same level. Therefore, there should be no additional adjustment in depreciation expense.

Question. Can any part of stockholders' equity be classified as monetary?

Answer. The Statement, in its simplified approach, does not address common stockholders' equity; therefore, consideration of whether some portion of stockholders' equity is monetary is not necessary.

The Statement is also silent about stockholders' equity other than common, but if comprehensive restatement is applied, the distinctions made in APB Statement No. 3 should be used.

Question. If a contract is negotiated taking into account cost increases over the life of the contract, would income in constant dollars be overstated in constant dollars if revenue from the contract is further adjusted to reflect changes in the CPI-U?

Answer. No. If revenues from the contract are smoothed (e.g., equal monthly revenues), in effect revenue of the first few months is higher to offset cost increases in subsequent months. Restating in terms of constant dollars will not change the historical cost relationships.

If revenues from the contract increase in relation to increasing costs (e.g., on a cost plus basis), the purchasing power of each month's revenue is approximately the same. Restating revenue in constant dollars will show a smooth flow of revenue, as intended in the contract.

Question. Is current-cost information required for investees owned 50% or less?

Answer. No. Current-cost information is required only for inventory and property, plant and equipment that are classified as such in the financial statements. The Statement does not require adjustments for the effects of changing prices on all other nonmonetary items. Accordingly, the nonmonetary portion of investments accounted for on the equity or cost basis in the financial statements is stated on the same basis in the supplementary information.

Question. Is an audit of the supplementary financial data required?

Answer. No. Although the information required by the Statement to be disclosed is considered to be an essential part of the financial reporting of certain entities, the information is supplementary and not part of the financial statements on which the auditor expresses an opinion.

The Auditing Standards Board has issued an Exposure Draft of a proposed Statement on Auditing Standards (SAS), *Reporting on Required Supplemental Information*, October 1, 1979, that would require the independent auditor to apply certain limited procedures to the required supplementary information. Also, the auditor is to report the nature of the procedures applied and the degree of responsibility taken, either in a separate report or in an additional paragraph of the report on the financial statements.

Compliance Checklist

To monitor compliance with the supplementary disclosure requirements of the Statement, the following checklist may be used. All "No" answers, if related to material amounts, indicate departures from the provisions of the Statement.

	Yes	No	N.A.
1. Is the enterprise required to comply with FASB Statement No. 33, <i>Financial Reporting and Changing Prices</i> , because it is a public enterprise whose primary statements are prepared in U.S. dollars and in accordance with U.S. GAAP <i>and</i> at the beginning of the year, had <i>either</i> (a) total assets in excess of \$1,000,000,000 <i>or</i> (b) inventory and property, plant and equipment (before deducting accumulated depreciation, depletion and amortization) in excess of \$125,000,000?	_____	_____	_____
2. If the enterprise is required to comply with FASB Statement No. 33, does every published annual report that contains the primary financial statements contain the supplementary information?	_____	_____	_____
3. Does the supplementary information include the following data for the current fiscal year, expressed in average-for-the-current-year dollars (or in end-of-current-year dollars if comprehensive restatement is used):			
a) Income (loss) from continuing operations, <i>both</i> (a) adjusted for the effects of general inflation (historical cost/constant dollar basis) <i>and</i> (b) on a current cost basis?	_____	_____	_____
b) Purchasing power gain or loss on net monetary items?	_____	_____	_____
c) Increases or decreases in the current cost amounts of inventory and property, plant and equipment (holding gains and losses) <i>both</i> (a) before <i>and</i> (b) after the effects of general inflation?	_____	_____	_____
d) Current cost of inventory and property, plant and equipment at the end of the fiscal year.	_____	_____	_____

	Yes	No	N.A.
4. Is the supplementary information on income from continuing operations presented in <i>either</i> (a) a statement format (disclosing revenues, expenses, gains and losses) <i>or</i> (b) a reconciliation format (disclosing adjustments to historical income from continuing operations)?	_____	_____	_____
5. Does the supplementary information on income from continuing operations disclose the amount of or adjustments to:			
a) Cost of goods sold?	_____	_____	_____
b) Depreciation, depletion and amortization expense?	_____	_____	_____
c) Reduction of historical-cost amounts to lower recoverable amounts (on a constant dollar basis only)?	_____	_____	_____
6. Does the supplementary information include the following data for the last five fiscal years expressed in <i>either</i> (a) average-1967 (base-year) dollars <i>or</i> (b) average-for-the-current-year dollars (or end-of-current-year dollars if comprehensive restatement is used)?			
a) Net sales and other operating revenues?	_____	_____	_____
b) Historical-cost information adjusted for general inflation (historical-cost/constant-dollar basis):			
1) income (loss) from continuing operations?	(*)_____	_____	_____
2) income (loss) per common share from continuing operations?	(*)_____	_____	_____
3) purchasing power gain or loss on net monetary items?	(*)_____	_____	_____
4) net assets at fiscal year-end?	(*)_____	_____	_____

(*) Data not required for fiscal years ending before December 25, 1979.

	Yes	No	N.A.
c) Current-cost information (on a current-cost basis):			
1) income (loss) from continuing operations?	(*)_____	_____	_____
2) income (loss) per common share from continuing operations?	(*)_____	_____	_____
3) net assets at fiscal year-end?	(*)_____	_____	_____
4) increases or decreases in the current-cost amounts of inventory and property, plant and equipment (holding gains or losses) net of inflation?	(*)_____	_____	_____
d) Other information:			
1) cash dividends declared per common share?	_____	_____	_____
2) market price per common share at fiscal year-end?	_____	_____	_____
3) average level of the Consumer Price Index for All Urban Consumers CPI-U?	_____	_____	_____
7. Do the notes to the supplementary information disclose:			
a) The principal types of information used to calculate current cost of inventory, property, plant and equipment, cost of goods sold and depreciation expense?	_____	_____	_____
b) The reasons for omitting current-cost information for the current fiscal year, when and if omitted because current-cost and constant-dollar data are not materially different?	_____	_____	_____
c) The average level of the CPI-U (or the year-end CPI-U, if comprehensive restatement is used) for each year included in the five-year summary?	_____	_____	_____

(*) Data not required for fiscal years ending before December 25, 1979.

	Yes	No	N.A.
d) The differences, if any, in the methods and estimates used in computing current-cost or constant-dollar depreciation expense from those used in computing historical cost depreciation expense?	_____	_____	_____
e) The aggregate amount of current-cost and constant-dollar depreciation expense, if such expense is allocated among various categories in the supplementary disclosures?	_____	_____	_____
f) A statement that historical income tax expense has not been modified for any timing differences, allocations or other adjustments that may result from applying the current-cost or constant-dollar bases in preparing the supplementary information?	_____	_____	_____
g) The basis for computing the amount of net assets at fiscal year-end (if comprehensive restatement is used)?	_____	_____	_____
8. Does the published annual report include:			
a) Explanations of the supplementary information disclosed?	_____	_____	_____
b) Discussion of the significance of the supplementary information in the circumstances of the enterprise?	_____	_____	_____

Appendix A. 1

Illustrative Disclosure Blank Company

Throughout the text of this booklet examples are given to illustrate the compilation of the required supplementary information. All the examples relate to the same hypothetical company, Blank Company.

In this Appendix the required disclosures are illustrated and certain additional background data are given, arranged as follows:

- Supplementary Financial Data Adjusted for the Effects of Changing Prices, for the Year Ended December 31, 1979:
 - Reconciliation format
 - Statement format
- Supplementary Five-Year Comparison of Selected Financial Data Adjusted for the Effects of Changing Prices:
 - In average 1979 dollars
 - In average 1967 (base-year) dollars
- Notes to the Supplementary Financial Data Adjusted for the Effects of Changing Prices
- Data for the Blank Company Illustrative Disclosure

The same data have been used to illustrate a comprehensive restatement on the constant dollar basis in Appendix A.2.

Reconciliation Format**BLANK COMPANY****Supplementary Financial Data Adjusted for the Effects of Changing Prices
For the Year Ended December 31, 1979
(In 000s of Dollars)**

Income from continuing operations as reported in the primary statement of income		\$4,750
Adjustment to restate costs for the effects of general inflation		
Cost of goods sold	(\$1,123)	
Depreciation	(385)	(1,508)
Income from continuing operations adjusted for the effects of general inflation (in average 1979 dollars)		3,242
Adjustment to reflect the difference between general inflation and changes in specific prices (current costs)		
Cost of goods sold	(877)	
Depreciation	(15)	(892)
Income from continuing operations adjusted for changes in specific prices (in average 1979 dollars)		<u>\$2,350</u>
Purchasing power loss on net monetary assets held during the year		<u>\$ 499</u>
Increase in current cost of inventory and equipment held during the year (based on specific price changes)		\$ 100
Effect of increase in general price level (*)		<u>2,327</u>
Decrease in current cost of inventory and equipment held during the year (based on specific price changes) net of changes in the general price level (net holding loss) (†)		<u>\$2,227</u>
<i>Inventory and Property, Plant and Equipment at December 31, 1979 Adjusted for Changes in Specific Prices—Current Costs</i>		
Inventory		<u>\$12,500</u>
Equipment—net of accumulated depreciation		<u>\$ 6,500</u>

(*) Presentation is not required by FASB Statement No. 33.

(†) The total increase in specific prices of inventory and equipment is less than the increase in the general price level during the year. This results in a *decrease* of the current costs in relation to the general price level.

Statement Format

BLANK COMPANY

**Supplementary Financial Data Adjusted for the Effects of Changing Prices
For the Year Ended December 31, 1979
(In 000s of Dollars)**

	<u>As Stated in the Financial Statements</u>	<u>Adjusted for General Inflation (in average 1979 dollars)</u>	<u>Adjusted for Changes in Specific Prices (Current Costs)</u>
Net sales	\$60,000	\$60,000	\$60,000
Cost of goods sold (exclusive of depreciation)	40,000	41,123	42,000
Operating expenses	8,000	8,000	8,000
Depreciation of equipment	2,000	2,385	2,400
Amortization of patents	500	500	500
Federal income taxes	4,750	4,750	4,750
Total expenses	<u>55,250</u>	<u>56,758</u>	<u>57,650</u>
Income from continuing operations	<u>\$ 4,750</u>	<u>\$ 3,242</u>	<u>\$ 2,350</u>
Purchasing power loss on net monetary assets held during the year		<u>\$ 499</u>	<u>\$ 499</u>
Increase in current cost of inventory and equipment held during the year (based on specific price changes)			\$ 100
Effect of increase in general price level (*)			<u>2,327</u>
Decrease in current cost of inventory and equipment held during the year (based on specific price changes) net of changes in the general price level (net holding loss) (†)			<u>\$ 2,227</u>
<i>Inventory and Property, Plant and Equipment at December 31, 1979</i>			
Inventory			<u>\$12,500</u>
Equipment—net of accumulated depreciation			<u>\$ 6,500</u>

(*) Presentation is not required by FASB Statement No. 33.

(†) The total increase in specific prices of inventory and equipment is less than the increase in the general price level during the year. This results in a decrease of the current costs in relation to the general price level.

BLANK COMPANY

Supplementary Five-Year Comparison of Selected

Financial Data Adjusted for the

Effects of Changing Prices

(Average 1979 Dollars, in 000s Except Per Share Data)

	Year Ended December 31			
	1975	1976	1977	1978
				1979
Historical cost information adjusted for general inflation				
Net sales	\$70,087	\$68,526	\$67,962	\$65,544
Income from continuing operations	*	*	*	*
Income from continuing operations per common share	*	*	*	*
Purchasing power gain (loss) on net monetary items held during the year	*	*	*	*
Net assets at year end	*	*	*	*
Current cost information†				
Income from continuing operations	*	*	*	*
Income from continuing operations per common share	*	*	*	*
Excess of increase (decrease) in current cost of inventory and equipment held during the year (based on specific price changes) over changes in the general price level	*	*	*	*
Net assets at year end	*	*	*	*
Other information				
Cash dividends declared per common share	3.03	3.17	2.98	3.34
Market price per common share at year end	67.98	62.36	67.67	64.14
Average Consumer Price Index	161	171	182	195
				217 (Estimated)

* Disclosure is not required for years ended before December 25, 1979

† Presentation of 1979 current-cost data may be deferred until 1980

BLANK COMPANY
Supplementary Five-Year Comparison of Selected
Financial Data Adjusted for the
Effects of Changing Prices
(Average 1967 Base-Year Dollars, in 000s Except Per Share Data)

	Year Ended December 31			
	1975	1976	1977	1978
				1979
Historical cost information adjusted for general inflation				
Net sales	\$32,298	\$31,579	\$31,319	\$29,744
Income from continuing operations	*	*	*	*
Income from continuing operations per common share	*	*	*	*
Purchasing power gain (loss) on net monetary items held during the year	*	*	*	*
Net assets at year end	*	*	*	*
Current cost information†				
Income from continuing operations	*	*	*	*
Income from continuing operations per common share	*	*	*	*
Excess of increase (decrease) in current cost of inventory and equipment held during the year (based on specific price changes) over changes in the general price level	*	*	*	*
Net assets at year end	*	*	*	*
Other information				
Cash dividends declared per common share	1.40	1.46	1.37	1.54
Market price per common share at year end	31.33	28.74	31.18	29.56
Average Consumer Price Index	161	171	182	195
				217 (Estimated)

*Disclosure is not required for years ended before December 25, 1979.

†Presentation of 1979 current-cost data may be deferred until 1980

Blank Company

Notes to the Supplementary Financial Data Adjusted for the Effects of Changing Prices

Note 1. Basis of preparation

The Company's primary financial statements are prepared based mainly on historical prices, that is, the prices that were in effect when the transactions occurred. The supplementary financial information discloses certain effects of inflation and changes in the prices of the Company's inventory and property, plant and equipment as required by Statement of Financial Accounting Standards No. 33, *Financial Reporting and Changing Prices*, issued by the Financial Accounting Standards Board.

Part of the information relating to years ended on or before December 31, 1978 is omitted, because it has proved impracticable to obtain such information.

The *Consumer Price Index for All Urban Consumers (CPI-U)*, prepared by the Bureau of Labor Statistics of the U.S. Department of Labor, is used to measure the effects of general inflation in the United States.

Note 2. Inventory and cost of goods sold

The current cost of inventory and cost of goods sold represents the cost of purchasing the goods concerned, or of acquiring the resources necessary to produce them, at year-end prices for inventory and at prices in effect at the date of sale for cost of goods sold. The information relating to prices at the different dates is obtained from current invoices, price lists and quotations from the Company's principal suppliers.

Note 3. Equipment and depreciation

To determine the current cost of equipment, the *Specific Price Index For Machinery* prepared by the Blank Industry Association, an independent trade association, is used. The Company believes that the application of this index results in a reasonable approximation of the current cost of acquiring used equipment with the same service potential as the equipment owned.

Current cost depreciation expense is determined on the basis of the average estimated current cost of equipment, using the same method and rates of depreciation as are used to prepare the Company's primary financial statements.

Note 4. Income taxes

As recommended by Statement of Financial Accounting Standards No. 33, no adjustments are made to income tax expense for any deferred income taxes that might be deemed to arise because of the differences between income reported on a current cost basis and income reported for tax purposes.

The income tax expense for the year shown in the primary financial statements is included in income from continuing operations adjusted for changes in specific prices (current costs). No portion of such tax expense is allocated to the increase or decrease in the current cost of inventory and equipment.

BLANK COMPANY

Data for the Illustrative Disclosure

The following data, presented for the Blank Company, provide a basis for illustrating the computations required by FASB Statement No. 33, *Financial Reporting and Changing Prices*, for the disclosure of the minimum information on income adjusted for general inflation (constant dollar basis) and income adjusted for changes in specific prices (current cost basis) and other disclosures.

1. Balance Sheet of Blank Company as of December 31, 1978

<u>Assets</u>			
<u>Current Assets</u>			
Cash			\$ 4,000
Accounts Receivable			6,000
Inventory (FIFO)			<u>8,000</u>
Total Current Assets			18,000
<u>Long-Term Assets</u>			
Equipment	\$10,000		
Accumulated Depreciation	<u>3,000</u>	7,000	
Patents		<u>5,500</u>	<u>12,500</u>
Total Assets			<u><u>\$30,500</u></u>
<u>Liabilities and Stockholders' Equity</u>			
<u>Current Liabilities</u>			
Accounts Payable			\$ 5,000
<u>Other Liabilities</u>			
Deferred Federal Income Taxes			<u>1,000</u>
Total Liabilities			6,000
<u>Stockholders' Equity</u>			
Capital Stock (1000 shares issued and outstanding)	\$16,500		
Retained Earnings	<u>8,000</u>		<u>24,500</u>
Total Liabilities and Stockholders' Equity			<u><u>\$30,500</u></u>

2. Combined Statement of Income and Retained Earnings of Blank Company for the Year Ended December 31, 1979

Sales		\$60,000
Cost of Goods Sold (exclusive of depreciation expense)	\$40,000	
Operating Expenses	8,000	
Depreciation of Equipment	2,000	
Amortization of Patents	500	50,500
Income Before Taxes		9,500
Federal Income Taxes		4,750
Net Income (\$4.75 per share)		4,750
Retained Earnings, 12/31/78		8,000
		12,750
Dividends Paid (\$3 per share)		3,000
Retained Earnings, 12/31/79		<u>\$ 9,750</u>

3. Balance Sheet of Blank Company as of December 31, 1979

Assets

Current Assets

Cash		\$ 8,000
Accounts Receivable		8,000
Inventory (FIFO)		12,000
Total Current Assets		28,000

Long-Term Assets

Equipment	\$10,000		
Accumulated Depreciation	<u>5,000</u>	5,000	
Patents		<u>5,000</u>	10,000
Total Assets			<u>\$38,000</u>

Liabilities and Stockholders' Equity

Current Liabilities

Accounts Payable	\$ 6,000
Taxes Payable	4,750
Total Current Liabilities	<u>10,750</u>

Other Liabilities

Deferred Federal Income Taxes	1,000
Total Liabilities	<u>11,750</u>

Stockholders' Equity

Capital Stock (1000 shares issued and outstanding)	\$16,500	
Retained Earnings	<u>9,750</u>	26,250
Total Liabilities and Stockholders' Equity		<u>\$38,000</u>

4. Additional Data

a. Current cost data

Inventory:

Current cost at 12/31/78	\$ 9,000
Current cost at 12/31/79	\$12,500
Units in inventory at 12/31/79	10,000
Current cost per unit at 12/31/79	\$ 1.25

Equipment (acquired in 1977):

Current cost at 12/31/78	\$10,300
Current cost at 12/31/79	\$ 6,500

Cost of goods sold:

Units sold	40,000
Weighted average current cost per unit	\$ 1.05

Specific price index for machinery:

December 1979 index	546
Average 1977 index	420

Recoverable costs of inventory and property, plant and equipment exceed current costs.

b. Other data

- Sales are not seasonal
- Purchases are uniform over the year and total \$44,000
- Operating expenses are uniform over the year
- Dividends are paid quarterly
- Depreciation rate is 20%, straight-line
- Patent, acquired 12/31/78, is amortized over 11 years
- Federal income tax rate is 50%

Consumer Price Index for All Urban Consumers (CPI-U):

Average Index:

1967	100 (Base year)
1975	161
1976	171
1977	182
1978	195
1979	217 (Estimated)

Monthly Index:

December 1978	203
December 1979	229 (Estimated)

Quarterly Index:

4th quarter 1978	202
2nd quarter 1979	214
4th quarter 1979	227 (Estimated)

c. Prior years' data

<u>Year</u>	<u>Net sales</u>	<u>Cash dividends per common share</u>	<u>Market price per share of common stock at year end</u>
1979	\$60,000	\$3.00	\$60
1978	58,000	3.00	60
1977	57,000	2.50	58
1976	54,000	2.50	50
1975	52,000	2.25	52

Appendix A. 2

Illustrative Disclosure of a Comprehensive Restatement Blank Company

The accompanying comprehensive restatement on a constant-dollar basis was prepared with the data used for the Blank Company illustrative disclosures (see Appendix A.1.) The restatement follows the outline of APB Statement No. 3 and the Exposure Draft issued by the FASB.

Any comparison of the results shown under the minimum disclosure basis and the comprehensive restatement should be made in the light of the following factors:

- The comprehensive restatement may be based on average dollars or year-end dollars of the current year. The minimum disclosure basis requires the use of average dollars. In the accompanying statement the comprehensive data are stated in year-end dollars.
- The comprehensive basis requires the restatement of all income statement and balance sheet items. The minimum disclosure basis requires the restatement of only inventory, property, plant and equipment, cost of goods sold and depreciation.

BLANK COMPANY**Comparison of Supplementary Financial Data
Adjusted for the Effects of Changing Prices
For the Year Ended December 31, 1979
(In 000s of Dollars)**

	<i>As Stated in the Financial Statements</i>	<i>Adjusted for General Inflation Minimum Basis (in Average 1979 Dollars)</i>	<i>Comprehensive Basis (in Year-End 1979 Dollars)</i>
Net sales	<u>\$60,000</u>	<u>\$60,000</u>	<u>\$63,300</u>
Cost of goods sold	40,000	41,123	43,388
Operating expenses	8,000	8,000	8,440
Depreciation of equipment	2,000	2,385	2,516
Amortization of patent	500	500	564
Federal income taxes	<u>4,750</u>	<u>4,750</u>	<u>5,013</u>
Total expenses	<u>55,250</u>	<u>56,758</u>	<u>59,921</u>
Income from continuing operations	<u>\$ 4,750</u>	<u>\$ 3,242</u>	<u>\$ 3,379</u>
Purchasing power loss on net monetary assets		<u>\$ 499</u>	<u>\$ 559</u>
Net assets, 12/31/79	<u>\$26,250</u>	<u>\$26,198</u>	<u>\$28,276</u>

Note: Required current cost supplementary information and the five-year summary information have been omitted. See Appendix A.1.

BLANK COMPANY**Comprehensive Restatement—Supporting Calculations****1. Income and expenses**

Items that were assumed to be uniform over the year were restated in year-end constant dollars by using as a conversion factor the ratio between the end-of-the-year CPI-U (229.0) and the average-for-the-year CPI-U (217.0).

	<i>As Stated in the Financial Statements</i>	<i>Conversion Factor</i>	<i>As Stated in Constant Dollars</i>
Net sales	\$60,000	$229.0 \div 217.0$	\$63,300
Operating expenses	\$ 8,000	$229.0 \div 217.0$	\$ 8,440
Federal income tax	\$ 4,750	$229.0 \div 217.0$	\$ 5,013
2. Cost of goods sold			
Inventory, 1/1/79	\$ 8,000	$229.0 \div 202.0$	\$ 9,064
Purchases	44,000	$229.0 \div 217.0$	46,420
Total	<u>52,000</u>		<u>55,484</u>
Inventory, 12/31/79	(12,000)	$229.0 \div 227.0$	(12,096)
Cost of goods sold	<u>\$40,000</u>		<u>\$43,388</u>
3. Depreciation of equipment			
Cost of asset (purchased in 1977)	<u>\$10,000</u>	$229.0 \div 182.0$	<u>\$12,580</u>
Depreciation expense		$(20\% \times \$12,580)$	<u>\$ 2,516</u>
Accumulated depreciation, 12/31/78		$(30\% \times \$12,580)$	<u>\$ 3,774</u>
Accumulated depreciation, 12/31/79		$(50\% \times \$12,580)$	<u>\$ 6,290</u>
4. Amortization of patent			
Cost of patent (purchased 12/31/78)	\$ 5,500	$229.0 \div 203.0$	\$ 6,204
Amortization	500	$(9.09\% \times \$6,204)$	564
Balance, 12/31/79	<u>\$ 5,000</u>		<u>\$ 5,640</u>
5. Quarterly dividend			
3/31/79	\$ 750	$229.0 \div 209.1$	\$ 821
6/30/79	750	$229.0 \div 216.6$	793
9/30/79	750	$229.0 \div 224.0$	766
12/31/79	750	$229.0 \div 229.0$	750
Total	<u>\$ 3,000</u>		<u>\$ 3,130</u>

6. Purchasing power gain or loss on net monetary items held

	<i>As Stated in the Financial Statements</i>	<i>As Stated in Constant Dollars</i>
Net monetary assets, 12/31/78	\$ 4.000	\$ 4,512 (*)
Additions:		
Sales	<u>60.000</u>	<u>63.300</u>
	<u>64.000</u>	<u>67.812</u>
Deductions:		
Purchases	(44.000)	(46.420)
Operating expenses	(8.000)	(8.440)
Dividends	(3.000)	(3.130)
Federal income taxes	<u>(4.750)</u>	<u>(5.013)</u>
	<u>(59.750)</u>	<u>(63.003)</u>
Net monetary assets, 12/31/79	<u>\$ 4,250</u>	<u>(4.250)</u>
Purchasing power loss on net monetary assets held		<u>\$ 559</u>

(*) Conversion factor: $229.0 \div 203.0$

7. Net assets at 12/31/79

Monetary assets	\$16,000	\$16,000
Monetary liabilities	(11,750)	(11,750)
Inventory	12,000	12,096
Equipment, net	5,000	6,290
Patent, net	<u>5,000</u>	<u>5,640</u>
Net assets, 12/31/79	<u>\$26,250</u>	<u>\$28,276</u>

Appendix A. 3

Illustrative Disclosure Blank Bank & Trust Company N.A.

This Appendix contains an example of the minimum one-year and five-year supplementary disclosures that would be appropriate for a banking institution. With minor modifications, the example could also be appropriate for a savings and loan association.

Because banks are normally restricted by the banking regulations in the amounts they may invest in premises and equipment and because they hold no inventories, there would normally be little difference between income from continuing operations as reported in the primary financial statements and income from continuing operations as adjusted for general inflation (constant dollars) or for changes in specific prices (current cost). If this is so, the current-cost information may be omitted.

In the example, the caption *Net interest margin (after provision for possible loan losses)* is presented instead of *Net sales and other operating revenues*, as this is the usual industry measure. This is the approach recommended by the advisory task force appointed by the FASB. However, the Statement does not address this matter. Enterprises not presenting this item in their primary financial statements should present gross interest income and other revenues.

In the example, Federal Reserve stock and real estate acquired through foreclosures have been considered nonmonetary assets. Such real estate may be considered as a monetary asset if it is held under contract at a specific price. Average Consumer Price Indices for 1979 and 1980 have been estimated.

BLANK BANK & TRUST COMPANY, N.A.

**Supplementary Financial Data Adjusted for the Effects of Changing Prices
For the Year Ended December 31, 1980
(In 000s of Dollars)**

	<i>As Stated in the Financial Statements</i>	<i>Adjusted for General Inflation (in average 1980 dollars)</i>	<i>Adjusted for Changes in Specific Prices (Current Costs)</i>
Net interest margin (after provision for possible loan losses)	\$30,000	\$30,000	\$30,000
Other income	10,000	10,000	10,000
Other expense	(7,500)	(7,625)	(8,500)
Provision for income taxes	(7,000)	(7,000)	(7,000)
Securities gains, net of tax effect	1,000	1,000	1,000
Income from continuing operations	<u>\$26,500</u>	<u>\$26,375</u>	<u>\$25,500</u>
Purchasing power loss on net monetary assets held during the year	<u>\$ 4,500</u>	<u>\$ 4,500</u>	<u>\$ 4,500</u>
Increase in current cost of premises and equipment held during the year (based on specific price changes) (*)			\$ 5,000
Effect of increase in general price level			<u>4,000</u>
Excess of increase in current cost of premises and equipment held during the year (based on specific price changes) over changes in the general price level			<u>\$ 1,000</u>
(*) At December 31, 1980, the current cost of premises and equipment, net of accumulated depreciation, was \$52,500.			

Note: If there is no material difference between the amount of income from continuing operations as adjusted for general inflation (constant dollars) and as adjusted for changes in specific prices (current costs), the information included within the black borders above may be omitted. The reason for such omission must be disclosed in a note to the supplementary disclosures.

BLANK BANK & TRUST COMPANY, N.A.

Supplementary Five-Year Comparison of Selected Financial Data Adjusted for the Effects of Changing Prices (Average 1980 Dollars, in 000s, Except Per Share Amounts)

	Year Ended December 31			
	1976	1977	1978	1979
Historical cost information adjusted for general inflation				
Net interest margin (after provision for possible loan losses)	\$25,200	\$30,130	\$26,840	\$ 29,700
Income before securities gains and losses				\$ 30,000
Income from continuing operations				25,375
				21,425
Per common share:				
Income before securities gains and losses		2.24		2.54
Income from continuing operations		2.14		2.64
Purchasing power loss on net monetary assets held during the year				2,750
				4,500
Net assets at year-end				220,000
				250,000

Current cost information

Income before securities gains and losses	21,500	24,500
Income from continuing operations	20,500	25,500
Per common share:		
Income before securities gains and losses	2.15	2.45
Income from continuing operations	2.05	2.55
Excess of increase in current cost of premises and equipment held during the year (based on specific price changes) over changes in the general price level		
Net assets at year-end	700	1,000
	225,000	255,000

Other information

Cash dividends declared per common share	1.12	1.05	.98	1.10
Market price per common share at year-end (bid)	34.30	34.06	28.67	37.40
Average Consumer Price Index	170.5	181.5	195.4	217.0
				238.0

Note: If there is no material difference between the amount of income from continuing operations as adjusted for general inflation (constant dollars) and as adjusted for changes in specific prices (current costs), the information included within the black borders above may be omitted. The reasons for any such omission must be disclosed in a note to the supplementary disclosures.

Appendix A. 4

Illustrative Disclosure Blank Electric Utility Company

This Appendix illustrates the supplementary disclosures that would be appropriate for a public utility enterprise. The example relates to an electric utility, but, with appropriate changes, it would be applicable to other types of public utilities.

Because regulatory agencies often determine rates on the basis of embedded costs of capital (historical cost), future cash flow may not be sufficient to recover current costs of property, plant and equipment. Under these circumstances, the Statement indicates that the asset amounts should be reduced to recoverable amounts (usually, value in use), but current cost depreciation should be computed based on the current cost of the assets.

In the example, it has been assumed that there is such a restriction, and that value in use is less than current cost but greater than historical cost adjusted for the effect of general inflation (constant dollars).

The operations of electric utilities are usually markedly seasonal, and the example has taken this into consideration, assuming a marked increase in first quarter operations and a substantial reduction in third quarter operations. It was deemed that the use of annual averages would therefore not be appropriate, and quarterly or monthly averages were used.

BLANK ELECTRIC UTILITY COMPANY
Supplementary Financial Data Adjusted
For the Effects of Changing Prices
For the Year Ended December 31, 1980
(In 000s of Dollars)

	<i>As Stated in the Financial Statements</i>	<i>Adjusted for General Inflation (In average 1980 dollars)</i>	<i>Adjusted for Change in Specific Prices (Current Costs)</i>
Operating revenues	<u>\$282,000</u>	<u>\$296,100</u>	<u>\$296,100</u>
Operating expenses:			
Operation and maintenance	112,000	117,600	117,600
Depreciation	43,750	65,450	82,750
Taxes other than income taxes	23,500	24,680	24,680
Income taxes	12,500	13,380	13,380
Total operating expenses	<u>191,750</u>	<u>221,110</u>	<u>238,410</u>
Operating income	90,250	74,990	57,690
Other income, including AFUDC (equity)	<u>7,000</u>	<u>7,350</u>	<u>7,350</u>
Income before interest expense	97,250	82,340	65,040
Interest expense, net of AFUDC (borrowed)	<u>50,000</u>	<u>52,500</u>	<u>52,500</u>
Income from continuing operations	<u>\$ 47,250</u>	<u>\$ 29,840</u>	<u>\$ 12,540</u>
Purchasing power gain on net monetary liabilities owed during the year		<u>\$ 33,000</u>	<u>\$ 33,000</u>
Increase in current cost of electric plant held during the year (based on specific price changes) (*)			\$120,000
Effect of increase in general price level			<u>115,000</u>
Excess of increase in current cost of electric plant held during the year (based on specific price changes) over changes in the general price level			<u>\$ 5,000</u>

(*) Current cost of depreciation for the year is calculated on the basis of the average current cost of electric plant, which at December 31, 1980, net of accumulated depreciation of \$650,000, was \$1,875,000. However, for purposes of reported current cost year-end balances, the electric plant is stated at its value in use to the Company, which at December 31, 1980 was \$1,783,000.

BLANK ELECTRIC UTILITY COMPANY
Supplementary Five-Year Comparison of Selected Financial Data
Adjusted for the Effects of Changing Prices
(Average 1980 Dollars, 000s Except Per Share Amounts)

	<i>Year Ended December 31</i>				
	<i>1976</i>	<i>1977</i>	<i>1978</i>	<i>1979</i>	<i>1980</i>
<i>Historical cost information adjusted for general inflation</i>					
Operating revenues	\$273,037	\$308,941	\$297,439	\$303,477	\$296,100
Income from continuing operations				28,910	29,840
Income from continuing operations per common share				1.82	1.62
Purchasing power gain on net monetary liabilities owed during the year				29,600	33,000
Net assets at year-end				795,000	820,000
<i>Current cost information</i>					
Income from continuing operations				11,960	12,540
Income from continuing operations per common share				.75	.68
Excess of increase in current cost of electric plant held during the year (based on specific price changes) over changes in the general price level				4,135	5,000
Net assets at year-end				835,900	865,400
<i>Other information</i>					
Cash dividends declared per common share	1.99	1.92	1.84	1.78	1.75
Market price per common share at year-end	24.95	24.08	23.50	23.14	22.50
<i>Average Consumer Price Index</i>					
	170.5	181.5	195.4	217.0	238.0

Appendix B

Guidance for Management's Discussion

The Statement requires that management provide explanations of the supplementary information and discuss its significance in relation to enterprise circumstances.

The advantages and disadvantages of constant dollar and current cost accounting have been discussed in various books and articles. Sources that may be used by management to support its explanations and discussion include the following:

- American Institute of Certified Public Accountants, Staff of the Accounting Research Division. Accounting Research Study No. 6, *Reporting the Financial Effects of Price-Level Changes*. (New York, AICPA, 1963).
- Burton, John C. "Accounting that Allows for Inflation (The Shortcomings of PuPU Accounting)," *Business Week*. Nov. 30, 1974.
- Davidson, Sidney, Clyde P. Stickney and Roman L. Weil. *Inflation Accounting: A Guide for the Accountant and the Financial Analyst*. (New York, McGraw-Hill, 1976).
- Financial Accounting Standards Board. Research Report, *Field Tests of Financial Reporting in Units of General Purchasing Power*. (FASB, 1977).
- Largay, James A. III and John Leslie Livingstone. *Accounting for Changing Prices*. (New York, John Wiley & Sons, 1976).
- Rosenfield, Paul. "Replacement Accounting—A Dead End," *Journal of Accountancy*. September, 1975.
- Seed, Allen H., III. *Inflation, Its Impact on Financial Reporting and Decision Making*. Financial Executives Research Foundation. (New York, 1978).
- Stickney, Clyde P. "Adjustments for Changing Prices." *Handbook of Modern Accounting*, edited by Sidney Davidson and Roman L. Weil. 2nd ed. (New York, McGraw-Hill, 1977).
- Stickney, Clyde P. and David O. Green. "No Price Level Adjusted Statements, Please," *The CPA Journal*, January, 1974.

The Statement identifies a number of advantages and disadvantages that were taken into account in deciding what supplementary disclosures should be required. The following is a summary of different points raised in the Statement that may be helpful to management in explaining and discussing the supplementary data.

The estimation of future cash flow is an important objective of users of financial statements. The supplementary information may provide additional means of estimating such future cash flows; for example:

- Current-cost data may be considered a conservative estimate of the net present value of future cash flow.
- Current-cost margin information together with current cost of inventory may be useful to assess cash flow, especially if selling prices reflect changes in costs.
- Assets that are stated at lower recoverable amounts are by definition stated at the present value of management's estimate of future cash flow.

Current-cost information may be useful in analyzing an enterprise's capability of maintaining its operating capacity without impairing its ability to declare dividends.

Alternately, constant-dollar information may be useful in analyzing an enterprise's capacity for maintaining the purchasing power of the shareholder's investment and of sustaining an adequate return on that investment.

The use of a uniform unit of measure (constant dollars) should enhance the results of ratio analysis and other usual comparisons of financial data. This uniformity should also enhance the significance of comparisons with other enterprises, both within the same industry and in other industries.

Inflation affects different prices in different ways. Therefore, presentation of holding gains or losses, both before and after deducting the effect of general inflation, highlights the specific effects of inflation on an enterprise's activities.

Appendix C

Differences Between the Replacement-Cost Requirements of SEC Accounting Series Release No. 190 and the Current-Cost Requirements of FASB Statement No. 33

ASR No. 190 requires the disclosure of certain supplementary information relating to inventories, cost of goods sold, productive capacity and depreciation, depletion and amortization, on a replacement cost basis. The information required by ASR No. 190 has some similarities to the current cost information required by the Statement, but there are important differences between the two requirements:

- ASR No. 190 requires the disclosure of certain data, but the disclosures required by the Statement are more extensive.
- ASR No. 190 applies to public enterprises with inventories and gross property, plant and equipment in excess of \$100 million. The requirements of the Statement are applicable to public enterprises with inventories and gross property, plant and equipment in excess of \$125 million or with total assets in excess of \$1 billion.
- ASR No. 190 excluded land, assets not intended to be replaced and construction in progress from the replacement cost requirements. The only exclusions from the current cost requirements of the Statement are income-producing real estate properties and unprocessed natural resources.
- A current replacement cost measurement of assets related to a contract or project may or may not be required by ASR No. 190 depending primarily on whether the contract or project is of a recurring nature; the Statement requires current cost measurements for all such assets, as of the date of use on or commitment to the contract.
- ASR No. 190 requires the disclosure of replacement cost with separate disclosure of net realizable value when it is lower. The Statement requires only the disclosure of current cost or lower recoverable amount (net realizable value or value in use, as appropriate).

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- The SEC's Staff Accounting Bulletin No. 7 defines replacement cost of an asset as the "lowest amount that would have to be paid in the normal course of business to obtain a *new asset* of equivalent operating or productive capability" (emphasis added). The Statement defines the current cost of an asset as "the amount of cash that would have to be paid to acquire an *identical asset* currently" (emphasis added).
 - Under ASR No. 190, cost of sales and inventory stated on a replacement cost basis may include expected cost savings from production and labor efficiencies resulting from obtaining new facilities and equipment. Under the Statement's current cost basis, cost savings cannot be assumed because there is no assumed change in assets.
 - ASR No. 190 requires the use of straight line depreciation when assets are being depreciated on any time-expired basis for historical cost purposes. The Statement requires the use of the same depreciation methods for current cost purposes as are used for historical cost purposes, unless the latter were chosen to offset in part the effect of inflation.

Appendix D

Illustrative Classification of Monetary and Nonmonetary Items

The Statement provides guidance for the classification of certain assets and liabilities as monetary or nonmonetary. The classifications indicated should not be utilized without adequate review of the circumstances involved in each individual application. Illustrated below is the application of the monetary and nonmonetary definitions under typical circumstances.

Monetary Items:

Assets

Cash on hand and demand bank deposits

Time deposits

Foreign currency (on hand and claims to foreign currency)

Preferred stock (nonconvertible and nonparticipating)

Bonds (other than convertible)

Accounts and notes receivable

Allowance for doubtful accounts

Variable rate mortgage loans

Loans to employees

Long-term receivables

Refundable deposits

Advances to unconsolidated subsidiaries

Cash surrender value of life insurance

Advances to suppliers (not on a fixed price contract)

Deferred income tax charges

Deferred life insurance policy acquisition costs

Liabilities

Accounts and notes payable

Accrued expenses payable

Cash dividends payable

Obligations payable in a foreign currency
Advances from customers (not on a fixed price contract)
Accrued losses on firm purchase commitments
Refundable deposits
Bonds payable and long-term debt
Unamortized premium or discount and prepaid interest on bonds or notes payable
Convertible bonds payable
Deferred income tax credits
Life insurance policy reserves
Property and casualty insurance loss reserves
Deposit liabilities of financial institutions

Nonmonetary Items:

Assets

Common stocks (not accounted for on the equity method)
Inventory (other than inventories used on contracts)
Equity investments in unconsolidated subsidiaries or other investees
Property, plant and equipment
Accumulated depreciation of property, plant and equipment
Purchase commitments (portion paid on fixed price contracts)
Patents, trademarks, licenses and formulas
Goodwill
Deferred property and casualty insurance policy acquisition costs
Other intangible assets and deferred charges

Liabilities

Sales commitments (portion collected on fixed price contracts)
Obligations under warranties
Deferred investment tax credit
Unearned property and casualty insurance premiums

Items Requiring Individual Analysis:

Assets

Preferred stock (convertible or participating) and convertible bonds

If the market values the security primarily as a bond, it is monetary; if it values the security primarily as a stock, it is nonmonetary.

Inventories used on contracts

If the future cash receipts on the contracts will not vary because of future changes in prices, they are monetary. Goods used on contracts to be priced at market upon delivery are nonmonetary.

Prepaid insurance, advertising, rents and other prepayments

Claims to future services are nonmonetary. Prepayments that are deposits, advance payments or receivables are monetary because the prepayment does not obtain a given quantity of future services but rather is a fixed money offset.

Pension, sinking and other funds under enterprise control

The specific assets in the fund should be classified as monetary or nonmonetary.

Liabilities

Accrued vacation pay

If it is paid at the wage rates as of the vacation dates and if those rates may vary, it is nonmonetary. If they do not vary, then it is monetary.

Deferred revenue

Nonmonetary if an obligation to furnish goods or services is involved.

Accrued pension obligations

Fixed amounts payable to a fund are monetary; all other amounts are nonmonetary.

Appendix E. 1

Brief Explanation of the CPI-U*

The Bureau of Labor Statistics describes the Consumer Price Index (CPI) as a measure of the average change in prices over time in a fixed market basket of goods and services. Effective with the January 1978 index, the Bureau of Labor Statistics began publishing CPIs for two population groups: (1) a new CPI for All Urban Consumers (CPI-U) which covers approximately 80 percent of the total non-institutional civilian population; and (2) a revised CPI for Urban Wage Earners and Clerical Workers (CPI-W) which represents about half the population covered by the CPI-U. The CPI-U includes, in addition to wage earners and clerical workers, groups which historically have been excluded from CPI coverage, such as professional, managerial, and technical workers, the self-employed, short-term workers, the unemployed, and retirees and others not in the labor force.

The CPI is based on prices of food, clothing, shelter, and fuels, transportation fares, charges for doctors' and dentists' services, drugs and the other goods and services that people buy for day-to-day living. Prices are collected in 85 urban areas across the country from over 18,000 tenants, 18,000 housing units for property taxes, and about 24,000 establishments—grocery and department stores, hospitals, filling stations, and other types of stores and service establishments. All taxes directly associated with the purchase and use of items are included in the index. Prices of food, fuels, and a few other items are obtained every month in all 85 locations. Prices of most other commodities and services are collected every month in the five largest geographic areas and every other month in other areas. Prices of most goods and services are obtained by personal visits of the Bureau's trained representatives. Mail questionnaires are used to obtain public utility rates, some fuel prices, and certain other items.

In calculating the index, price changes for the various items in each location are averaged together with weights which represent their importance in the spending of the appropriate population group. Local data are then combined to obtain a U.S. city average.

The index measures price changes from a designated reference date—1967—which equals 100.0. An increase of 22 percent, for example, is shown as 122.0. This change can also be expressed in dollars as follows: The price of a base period "market basket" of goods and services in the CPI has risen from \$10 in 1967 to \$12.20.

Included in Appendix E. 2 are the monthly index numbers calculated by the U.S. Department of Labor. The years presented are those considered relevant for complying with the Statement.

* *CPI Detailed Report*—Bureau of Labor Statistics, U.S. Department of Labor.

Appendix E. 2.

U.S. Department of Labor, Consumer Price Index for All Urban Consumers (CPI-U) (1967 = 100)

YEAR	JAN.	FEB.	MAR.	APR.	MAY	JUNE	JULY	AUG.	SEP.	OCT.	NOV.	DEC.	AVG.
1919	49.5	48.4	49.0	49.9	50.6	50.7	52.1	53.0	53.3	54.2	55.5	56.7	51.8
1920	57.8	58.5	59.1	60.8	61.8	62.7	62.3	60.7	60.0	59.7	59.3	58.0	60.0
1921	57.0	55.2	54.8	54.1	53.1	52.8	52.9	53.1	52.5	52.4	52.1	51.8	53.6
1922	50.7	50.6	50.0	50.0	50.0	50.1	50.2	49.7	49.8	50.1	50.3	50.5	50.2
1923	50.3	50.2	50.4	50.6	50.7	51.0	51.5	51.3	51.6	51.7	51.8	51.8	51.1
1924	51.7	51.5	51.2	51.0	51.0	51.0	51.1	51.0	51.2	51.4	51.6	51.7	51.2
1925	51.8	51.6	51.7	51.6	51.8	52.4	53.1	53.1	52.9	53.1	54.0	53.7	52.5
1926	53.7	53.5	53.2	53.7	53.4	53.0	52.5	52.2	52.5	52.7	52.9	52.9	53.0
1927	52.5	52.1	51.8	51.8	52.2	52.7	51.7	51.4	51.7	52.0	51.9	51.8	52.0
1928	51.7	51.2	51.2	51.3	51.6	51.2	51.2	51.3	51.7	51.6	51.5	51.3	51.3
1929	51.2	51.1	50.9	50.7	51.0	51.2	51.7	51.9	51.8	51.8	51.7	51.4	51.3
1930	51.2	51.0	50.7	51.0	50.7	50.4	49.7	49.4	49.7	49.4	49.0	48.3	50.0
1931	47.6	46.9	46.6	46.3	45.8	45.3	45.2	45.1	44.9	44.6	44.1	43.7	45.6
1932	42.8	42.2	42.0	41.7	41.1	40.8	40.8	40.3	40.1	39.8	39.6	39.2	40.9
1933	38.6	38.0	37.7	37.6	37.7	38.1	39.2	39.6	39.6	39.6	39.6	39.4	38.8
1934	39.6	39.9	39.9	39.8	39.9	40.0	40.0	40.1	40.7	40.4	40.3	40.2	40.1
1935	40.8	41.1	41.0	41.4	41.2	41.1	40.9	40.9	41.1	41.1	41.3	41.4	41.1
1936	41.4	41.2	41.0	41.0	41.0	41.4	41.6	41.9	42.0	41.9	41.9	41.9	41.5
1937	42.2	42.3	42.6	42.8	43.0	43.1	43.3	43.4	43.8	43.6	43.3	43.2	43.0
1938	42.6	42.2	42.2	42.4	42.2	42.2	42.3	42.2	42.2	42.0	41.9	42.0	42.2
1939	41.8	41.6	41.5	41.4	41.4	41.4	41.4	41.4	42.2	42.0	42.0	41.8	41.6
1940	41.7	42.0	41.9	41.9	42.0	42.1	42.0	41.9	42.0	42.0	42.0	42.2	42.0
1941	42.2	42.2	42.4	42.8	43.1	43.9	44.1	44.5	45.3	45.8	46.2	46.3	44.1
1942	46.9	47.3	47.9	48.2	48.7	48.8	49.0	49.3	49.4	49.9	50.2	50.6	48.8
1943	50.6	50.7	51.5	52.1	52.5	52.4	52.0	51.8	52.0	52.2	52.1	52.2	51.8
1944	52.1	52.0	52.0	52.3	52.5	52.6	52.9	53.1	53.1	53.1	53.1	53.3	52.7
1945	53.3	53.2	53.2	53.3	53.7	54.2	54.3	54.3	54.1	54.1	54.3	54.5	53.9
1946	54.5	54.3	54.7	55.0	55.3	55.9	59.2	60.5	61.2	62.4	63.9	64.4	58.5
1947	64.4	64.3	65.7	65.7	65.5	66.0	66.6	67.3	68.9	68.9	69.3	70.2	66.9

1948	71.0	70.4	70.2	71.2	71.7	72.2	73.1	73.4	73.4	73.1	72.6	72.1	72.1
1949	72.0	71.2	71.4	71.5	71.4	71.5	71.0	71.2	71.5	71.1	71.2	70.8	71.4
1950	70.5	70.3	70.6	70.7	71.0	71.4	72.1	72.7	73.2	73.6	73.9	74.9	72.1
1951	76.1	77.0	77.3	77.4	77.7	77.6	77.7	77.7	78.2	78.6	79.0	79.3	77.8
1952	79.3	78.8	78.8	79.1	79.2	79.4	80.0	80.1	80.0	80.1	80.1	80.0	79.5
1953	79.8	79.4	79.6	79.7	79.9	80.2	80.4	80.6	80.7	80.9	80.6	80.5	80.1
1954	80.7	80.6	80.5	80.3	80.6	80.7	80.7	80.6	80.4	80.2	80.3	80.1	80.5
1955	80.1	80.1	80.1	80.1	80.1	80.1	80.4	80.2	80.5	80.5	80.6	80.4	80.2
1956	80.3	80.3	80.4	80.5	80.9	81.4	82.0	81.9	82.0	82.5	82.5	82.7	81.4
1957	82.8	83.1	83.3	83.6	83.8	84.3	84.7	84.8	84.9	84.9	85.2	85.2	84.3
1958	85.7	85.8	86.4	86.6	86.6	86.7	86.8	86.7	86.7	86.7	86.8	86.7	86.6
1959	86.8	86.7	86.7	86.8	86.9	87.3	87.5	87.4	87.7	88.0	88.0	88.0	87.3
1960	87.9	88.0	88.0	88.5	88.5	88.7	88.7	88.7	88.8	89.2	89.3	89.3	88.7
1961	89.3	89.3	89.3	89.3	89.3	89.4	89.8	89.7	89.9	89.9	89.9	89.9	89.6
1962	89.9	90.1	90.3	90.5	90.5	90.5	90.7	90.7	91.2	91.1	91.1	91.0	90.6
1963	91.1	91.2	91.3	91.3	91.3	91.7	92.1	92.1	92.1	92.2	92.3	92.5	91.7
1964	92.6	92.5	92.6	92.7	92.7	92.9	93.1	93.0	93.2	93.3	93.5	93.6	92.9
1965	93.6	93.6	93.7	94.0	94.2	94.7	94.8	94.6	94.8	94.9	95.1	95.4	94.5
1966	95.4	96.0	96.3	96.7	96.8	97.1	97.4	97.9	98.1	98.5	98.5	98.6	97.2
1967	98.6	98.7	98.9	99.1	99.4	99.7	100.2	100.5	100.7	101.0	101.3	101.6	100.0
1968	102.0	102.3	102.8	103.1	103.4	104.0	104.5	104.8	105.1	105.7	106.1	106.4	104.2
1969	106.7	107.1	108.0	108.7	109.0	109.7	110.2	110.7	111.2	111.6	112.2	112.9	109.8
1970	113.3	113.9	114.5	115.2	115.7	116.3	116.7	116.9	117.5	118.1	118.5	119.1	116.3
1971	119.2	119.4	119.8	120.2	120.8	121.5	121.8	122.1	122.2	122.4	122.6	123.1	121.3
1972	123.2	123.8	124.0	124.3	124.7	125.0	125.5	125.7	126.2	126.6	126.9	127.3	125.3
1973	127.7	128.6	129.8	130.7	131.5	132.4	132.7	135.1	135.5	136.6	137.6	138.5	133.1
1974	139.7	141.5	143.1	143.9	145.5	146.9	148.0	149.9	151.7	153.0	154.3	155.4	147.7
1975	156.1	157.2	157.8	158.6	159.3	160.6	162.3	162.8	163.6	164.6	165.6	166.3	161.2
1976	166.7	167.1	167.5	168.2	169.2	170.1	171.1	171.9	172.6	173.3	173.8	174.3	170.5
1977	175.3	177.1	178.2	179.6	180.6	181.8	182.6	183.3	184.0	184.5	185.4	186.1	181.5
1978	187.2	188.4	189.8	191.5	193.3	195.3	196.7	197.8	199.3	200.9	202.0	202.9	195.4
1979	204.7	207.1	209.1	211.5	214.1	216.6	218.9	221.1	223.4	225.4			

Appendix E. 3

Sources of Specific Price Indices

The United States Government is the primary source of price indices that may be useful for estimating current costs. The Bureau of Labor Statistics (BLS) compiles the principal series of data on prices, earnings, and production. Much of the price data is available on computer tapes from the BLS. The most widely used series of the BLS in the area of industrial prices include *Wholesale Prices and Price Indexes* and "Current Labor Statistics."

Wholesale Prices and Price Indexes is a monthly publication of the all-commodity index, including manufactured items, that dates back to the 1890s. Commodities are grouped into broad categories with each category broken into sub-groups. Approximately 2700 sub-indices are maintained, with most of these series dating back at least to 1947. Commodities are also grouped into broad industry-sector indices with sub-groups in each section by 4- and 5-digit Standard Industrial Classification codes. There is a two-month delay in reporting the series. The commodity specifications for each of the sub-indices are available only on microfiche from the BLS.

"Current Labor Statistics" is a monthly tabulation of 37 groups of data on employment, prices, and production derived from the principal BLS series. Table 18 is an index of hourly earnings by major industrial division and table 31 is an index of productivity. This series is published by the BLS in the *Monthly Labor Review* magazine with a two-month delay in reporting.

The methods and techniques used in developing the various statistical series by the BLS are described in the *Handbook of Methods for Surveys and Studies*, Bulletin 1711, which is available from the Government Printing Office as well as the regional offices of the BLS.

The U.S. Department of Commerce publishes a monthly *Survey of Current Business*. The survey contains several series on prices which are gathered from a number of public and private sources. The survey is supplemented biennially by a cumulative compilation for all of the series. The biennial supplement contains detailed information on the sources for each series.

The Bureau of the Census of the U.S. Department of Commerce compiles data every five years on manufacturing establishments. These data are published in its *Census of Manufacturers*. The Bureau of the Census also compiles monthly a composite Construction Cost Index of units of materials and labor. This index, which is a composite of several published indices plus internally developed adjustment factors, is published in *Construction Review* magazine.

In addition to the indices published by the Government, a dozen or more private concerns publish or sell data on construction and equipment costs. Trade associations and journals are the most widely available sources of such private data. Four magazines are frequently cited as sources of price indices and data for industrial equipment and construction: *Chemical Engineering*; *Engineering News Record*; *National Labor News*; *Oil and Gas Journal*.

Several companies collect data on equipment and construction costs and prepare price indices from these data. These indices are generally sold on a subscription basis. Construction-cost indices for twenty-two typical United States cities and a national index are published by American Appraisal Company; the indices are based on the costs of four types of commercial and industrial buildings. General equipment- and building-cost indices are published by Marshall and Swift Publication Company. Factory Mutual Engineering publishes industry level indices of equipment costs. The Handy-Whitman indices of water, and of gas and electric utility construction costs are published by Whitman-Requardt & Associates.

In addition to the companies that collect data on construction and equipment prices a number of companies are establishing computerized data banks of public and private indices. These firms generally offer a valuation service for adjusting the historical costs of a company's fixed assets by application of commodity-specific indices.

Appendix F

Glossary

ASR No. 190. Accounting Series Release No. 190, issued by the Securities and Exchange Commission, requires reports issued by certain companies to include measurement of cost of goods sold, depreciation, inventory and property, plant and equipment on the basis of replacement cost.

Backlog depreciation. The Statement defines backlog depreciation at the end of an asset's useful life to be "the gap between the total depreciation expense during the life of an asset and its current cost at the end of its life." The backlog depreciation at any point in the life of an asset may be measured by the gap between depreciation to date (accumulated depreciation) based on the year-end replacement cost ("gross" current cost) and the cumulative amount of current cost depreciation charged to income.

Base-year dollars. Dollars having purchasing power equal to that of dollars of the base period used by the particular index. For the CPI-U, 1967 is currently the base year, and 1967 dollars are base-year dollars. (See Appendix E. 1.)

Constant dollar. A dollar having a constant general purchasing power.

Constant-dollar accounting. Accounting and reporting using a constant-dollar unit of measurement.

Consumer Price Index. The Consumer Price Index for All Urban Consumers published by the Bureau of Labor Statistics of the U.S. Department of Labor. (See Appendices E. 1 and E. 2.)

CPI-U. The Consumer Price Index for All Urban Consumers.

Current cost. The cost of replacing the identical asset owned, that is, one of the same age and of the same operating capacity. Measurement of current cost based on a new asset requires adjustments for depreciation to date and for any differences between the operating capacities and operating costs of the new asset and the asset owned.

Current-cost accounting. Accounting and reporting based on current costs or lower recoverable amounts measured at the balance sheet date, or date of use or sale, if earlier within the period.

Current-cost / constant-dollar accounting. Current-cost accounting using a constant-dollar unit of measure.

Current replacement cost. The lowest cost of replacing an asset owned with a new asset of equivalent operating capability (incorporating advanced technology, if available), and adjusted for depreciation to date based on the age or expired life of the asset owned.

Direct pricing. Pricing by reference to current prices of comparable assets.

General inflation. A rise in the general level of prices or a decline in the general purchasing power of the monetary unit.

Historical-cost / constant-dollar accounting. Transaction-based accounting using historical prices measured in constant dollars.

Historical-cost / nominal-dollar accounting. Transaction-based accounting using historical prices measured in actual dollars of the period of the transaction.

Holding gain or loss. Increase or decrease in the current costs, or lower recoverable amounts, of inventory and property, plant and equipment held during the year. Holding gain or loss may be stated in average dollars or in constant dollars.

Income from continuing operations. Income after deducting income taxes, exclusive of the results of discontinued operations, extraordinary items and the cumulative effects of accounting changes.

Inventory. Raw materials and supplies, goods finished and in process of manufacture, and merchandise on hand, in transit, in storage, or consigned to others.

Monetary assets. Assets whose amounts are fixed in terms of units of currency by contract or otherwise and that are not dependent on future prices. (See also definition appearing in APB Opinion No. 29, *Accounting for Nonmonetary Transactions*.)

Monetary liabilities. Indebtedness or obligations whose amounts are fixed in terms of currency by contract or otherwise, and that are not dependent on future prices. (See also definition appearing in APB Opinion No. 29, *Accounting for Nonmonetary Transactions*.)

Net monetary items. The net balance of monetary assets less monetary liabilities.

Net realizable value. Dollar proceeds from the sale of an asset, net of related or out-of-pocket costs incurred to make the sale.

Nominal dollars. Dollars expressed without adjustment for changes in the underlying value of the dollar. The basis of measurement in the primary historical-cost financial statements.

Primary financial statements. The annual financial statements presented in reports to stockholders, including the balance sheet, income statement, statement of changes in financial position, and accompanying footnotes.

Public enterprise. A business enterprise (a) whose debt or equity securities are traded on a United States stock exchange or the over-the-counter market, including securities quoted only locally or regionally, or (b) an enterprise that is required to file financial statements with the Securities and Exchange Commission. An enterprise is considered to be a public enterprise as soon as its financial statements are issued for the sale of any class of securities in a domestic market. This definition differs slightly from the one included in FASB Statement No. 21, *Suspension of the Reporting of Earnings Per Share and Segment Information by Nonpublic Enterprises*.

Purchasing power. The quantity of a particular class of goods and services that may be purchased for a given sum of money at a given time or for a given period.

Purchasing power gain or loss on net monetary items held.

The gain or loss of purchasing power resulting from the holding of monetary items during a period of changing prices. In inflationary periods, the purchasing power of monetary assets held declines, giving rise to losses, whereas the decline in the purchasing power of the units of money needed to liquidate monetary liabilities results in purchasing power gains.

Recoverable amount. An estimate of the net realizable value of an asset subject to near-term sale or the net present value of expected future cash flows derived from an asset that is to be used in business operations.

Roll back. To restate in constant dollars of a prior period amounts stated in current-period constant dollars.

Roll forward. To restate in current-period constant dollars amounts expressed in prior-period constant dollars.

Supplementary disclosures. Information outside of the basic financial statements required to be presented by professional standards or voluntarily presented by the reporting entity. Required supplementary information should be distinct from the basic financial statements and separately identifiable from other information outside the financial statements.

Value in use. The net present value of future cash flows, including the proceeds of the ultimate disposal, expected to be derived from the use of an asset in an enterprise.

Appendix G

Statement of Financial Accounting Standards No. 33

Financial Reporting and Changing Prices

September 1979

INTRODUCTION

1. This Statement establishes standards for reporting certain effects of price changes on business enterprises. It deals with both general inflation and changes in the prices of certain specific types of assets. It requires no changes in the basic financial statements; the required information is to be presented in supplementary statements, schedules, or supplementary notes in financial reports. This Statement applies only to certain large, publicly held enterprises.

The Objectives of This Statement

2. This Statement is based on the objectives set out in FASB Concepts Statement No. 1, *Objectives of Financial Reporting by Business Enterprises*. That Statement concludes that financial reporting should provide information to help investors, creditors, and others assess the amounts, timing, and uncertainty of prospective net cash inflows to the enterprise (paragraph 37). It also calls for the provision of information about the economic resources of an enterprise in a manner that provides direct and indirect evidence of cash flow potential (paragraphs 40 and 41) and it concludes that management is accountable to the owners for "protecting them to the extent possible from unfavorable economic impacts of factors in the economy such as inflation or deflation" (paragraph 50).

3. The users of financial reports need to have an understanding of the effects of changing prices on a business enterprise to help their decisions on investment, lending, and other matters. This Statement is intended to help users in the following specific ways:

- a. **Assessment of future cash flows.** Present financial statements include measurements of expenses and assets at historical

prices. When prices are changing, measurements that reflect current prices are likely to provide useful information for the assessment of future cash flows.

- b. Assessment of enterprise performance. The worth of an enterprise can be increased as a result of prudent timing of asset purchases when prices are changing. That increase is one aspect of performance even though it may be distinguished from operating performance. Measurements that reflect current prices can provide a basis for assessing the extent to which past decisions on the acquisition of assets have created opportunities for earning future cash flows.
- c. Assessment of the erosion of operating capability. An enterprise typically must hold minimum quantities of inventory, property, plant, and equipment and other assets to maintain its ability to provide goods and services. When the prices of those assets are increasing, larger amounts of money investment are needed to maintain the previous levels of output. Information on the current prices of resources that are used to generate revenues can help users to assess the extent to which and the manner in which operating capability has been maintained.
- d. Assessment of the erosion of general purchasing power. When general price levels are increasing, larger amounts of money are required to maintain a fixed amount of purchasing power. Investors typically are concerned with assessing whether an enterprise has maintained the purchasing power of its capital. Financial information that reflects changes in general purchasing power can help with that assessment.

4. The needs described in paragraph 3 are important to investors, creditors, and also to other users. If information about the effects of changing prices is not available, the cost of capital may be excessive for enterprises that can use capital most effectively. Resources may be allocated inefficiently and all members of society may suffer. Furthermore, people in government who participate in decisions on economic policy may not obtain the most relevant information on which to base their decisions.

5. Many people recognize that the effects of changing prices should be taken into account in the interpretation of information in the financial reports of business enterprises. However, there

are several reasons for believing that those effects cannot be understood adequately until they are measured and disclosed in financial reports:

- a. The effects depend on the transactions and circumstances of an enterprise and users do not have detailed information about those factors;
- b. Effective financial decisions can take place only in an environment in which there is an understanding by the general public of the problems caused by changing prices; that understanding is unlikely to develop until business performance is discussed in terms of measures that allow for the impact of changing prices;
- c. Statements by business managers about the problems caused by changing prices will not have credibility until specific quantitative information is published about those problems.

The Usefulness of Present Financial Statements

6. Most people believe that the primary financial statements should continue to incorporate measurements based mainly on historical prices. Those financial statements rely to a great extent on prices in transactions to which the enterprise was a party. Among the most common and important transactions are sales in which the historical selling prices are used to measure receivables and purchases in which the historical buying prices are used to measure the inventories and property, plant, and equipment acquired. In present financial statements, those historical prices are measured in terms of the number of units of money agreed upon by the buyer and seller at the time of the transaction.

7. There are at least four important reasons for supporting the dominant focus of present financial statements on historical prices. First, it is fitting that the financial statements depend on actual transactions of the enterprise because those transactions determine the changes in owners' equity in the long run. Business enterprises invest cash in assets in order to earn more cash. Historical prices provide the elementary measures of both the amounts invested and the amounts received in return. Second, because historical prices generally are the result of arms-length bargaining,

they provide a basis for reliable measures of the results of transactions. Accordingly, financial statements prepared on the basis of historical prices tend to be capable of independent verification and can be prepared and used with confidence that the information presented is reliable. Third, users' understanding of the effect of changing prices may be enhanced if they are able to compare the measurements in the primary financial statements with measurements that reflect changing prices. Fourth, users are accustomed to the present financial statements.

The Need for Supplementary Information

8. The term "general inflation" means a rise in the general level of prices or a decline in the general purchasing power of the monetary unit. It is widely perceived to be an unfortunate but persistent current feature of the economies of most countries, including the United States. However, measurements in conventional statements are made in nominal dollars, with no direct allowance for the variability of their purchasing power. Many people believe that the users of financial reports need information about measurements that are made in units having the same (i.e., constant) general purchasing power. This Statement requires disclosure of certain supplementary information measured in units having the same general purchasing power. The method used to compute that information is known as constant dollar accounting.

9. Changes in the relative prices of specific goods and services are an integral feature of all modern economies. Many people believe that financial statements based on historical cost fail to provide sufficient information for users because those statements normally do not identify separately changes in prices of assets while they are held by an enterprise. This Statement requires disclosure of certain supplementary information based on measurement of the current cost of inventories and property, plant, and equipment. The method used to compute that information is known as current cost accounting.

10. The Board has concluded that there is an urgent need for enterprises to provide information about the effects on their activities of general inflation and other price changes. It believes

that users' understanding of the past performance of an enterprise and their ability to assess future cash flows will be severely limited until such information is included in financial reports.

The Need for Experimentation

11. Both constant dollar accounting and current cost accounting have been subjects of intensive study for many years. Various methodologies similar to constant dollar accounting have been employed to some extent in several countries. In the United States, 101 enterprises participated in the Financial Accounting Standards Board field test experiment with constant dollar accounting by preparing experimental financial statements for one or more of the years 1972-1974. A few U.S. companies have published constant dollar financial statements for several years; others say that they have prepared similar statements for internal use.

12. Preparers and users of financial reports have had wide experience with measurements similar to current cost. The last-in, first-out inventory method typically produces cost of goods sold (but not inventory) measurements that are similar to those obtained from the use of current cost. Starting with 1976, reports filed by certain companies with the Securities and Exchange Commission (SEC) have included measurements of cost of goods sold, depreciation, inventory and property, plant, and equipment on the basis of replacement cost, an attribute that frequently is similar to current cost. Income statements and supplementary schedules based on current cost accounting recently have been presented by several enterprises in the United Kingdom, Canada, and Australia.

13. Preparers and users of financial reports have not yet reached a consensus on the general, practical usefulness of constant dollar information and current cost information. It seems unlikely that a consensus can be reached until further experience has been gained with the use of both types of information in systematic practical applications. This Statement therefore requires certain enterprises to present information both on a constant dollar basis and on a current cost basis.

14. The measurement and use of information on changing prices will require a substantial learning process on the part of all concerned. The Board makes no pretense of having solved all of the implementation problems. Rather, it encourages experimentation within the guidelines of this Statement and the development of new techniques that fit the particular circumstances of the enterprise. This Statement has been written to provide more flexibility than is customary in Board Statements in the belief that those involved will help to develop techniques that further the understanding of the effects of price changes on the enterprise. In view of the importance of clear explanations of the significance of information on the effects of changing prices, to assist users' understanding of the information, the Board is organizing an advisory group to develop illustrative disclosures that might be appropriate for particular industries.

15. The requirement to present information on both a constant dollar basis and a current cost basis provides a basis for studying the usefulness of the two types of information. The Board intends to study the extent to which the information is used, the types of people to whom it is useful, and the purpose for which it is used. The requirements of this Statement will be reviewed on an ongoing basis and the Board will amend or withdraw requirements whenever that course is justified by the evidence. This Statement will be reviewed comprehensively after a period of not more than five years.

Accounting Series Release No. 190

16. As noted in paragraph 12, the Securities and Exchange Commission has required the filing of information having some similarities to the current cost accounting information called for in this Statement. That requirement is included in Accounting Series Release No. 190, *Notice of Adoption of Amendments to Regulation S-X Requiring Disclosure of Certain Replacement Cost Data*. However, it is important that the differences between the two sets of information be recognized. This Statement requires presentation of a computation of income from continuing operations using current cost information. ASR 190, however, calls for information that is not suitable for integration into a computation of income. It requires the disclosure of cost of goods sold

at current replacement cost and of depreciation on the basis of the current cost of replacing productive capacity; and the current cost of replacing productive capacity may not be commensurate with labor costs and other operating costs reflected in the income statement. Consequently, ASR 190 emphasizes information that would assist in understanding the "current economics of the business" and it specifically states that the SEC "determined not to require the disclosure of the effect on net income" and that it "did not believe that users should be encouraged to convert the data into a single revised net income figure" (page 7). Some users have nevertheless made that conversion.

17. This Statement emphasizes measurement of the assets owned by the enterprise, whereas ASR 190 focuses attention on the assets that would replace those owned if replacement were to occur currently. Furthermore, this Statement provides for use of current cost or lower recoverable amount as the measure of the asset and of its consumption, rather than requiring use of only one measure—replacement cost—with separate disclosure of net realizable value when it is lower. This Statement calls for disclosure of increases or decreases in the current cost amounts of inventory and property, plant, and equipment as well as calling for measurement of expenses and assets at current cost; and unlike ASR 190, it also requires specific disclosures of the effects of changes in the general price level.

18. The Board is aware of and agrees with the belief that the continuation of requirements to measure both replacement cost data as required by ASR 190 and current cost data as required by this Statement will involve excessive costs for business enterprises. If the Securities and Exchange Commission does not rescind ASR 190 when this Statement becomes effective, the Board will take that factor into account in its decisions about the timing of its review of this Statement and the nature of any revisions to this Statement.

Special Industry Problems

19. Special problems arise in the application of the provisions of this Statement to several particular industries. Special industry task groups have assisted the Board in its study of those problems.

In the case of financial institutions such as commercial banks, thrift institutions, and insurance companies, the Board has concluded that the general provisions of this Statement are useful and applicable. In other cases, such as forest products, mining, oil and gas, and real estate, the Board has concluded that further studies are required to provide a basis for decisions on the applicability to certain types of assets and expenses, of the requirement to present information on a current cost basis. The Board intends to undertake those studies with the help of its advisory task groups, and it aims to publish one or more Exposure Drafts followed in 1980 by Statements dealing with the assets concerned. In the meantime, enterprises are not required to disclose information about the current costs of unprocessed natural resources and income-producing real estate properties. There are no special exemptions from requirements to disclose information on a historical cost/constant dollar basis.

Organization of This Statement

20. Paragraph 22 defines certain terms used in this Statement. Paragraphs 23–28 specify the applicability and scope of this Statement; and paragraphs 29–38 summarize the requirements for the disclosure of supplementary information. Paragraphs 39–50 contain provisions for the measurement of historical cost/constant dollar information in annual reports for fiscal years ended on or after December 25, 1979. Paragraphs 51–60 contain provisions for the measurement of current cost information by those enterprises. The current cost information is required for fiscal years ended on or after December 25, 1979 but first disclosure of the information may be postponed to annual reports for fiscal years ended on or after December 25, 1980. Paragraphs 61–64 contain provisions applicable to both historical cost/constant dollar measurements and current cost measurements. Paragraphs 65 and 66 contain provisions for the presentation of a five-year summary of selected data; and paragraphs 67–69 state the transitional provisions and effective dates of this Statement.

21. Illustrations of schedules that display the information required by this Statement are presented in Appendix A. Appendix B provides background information. The bases for the Board's

conclusions are set out in Appendix C. Illustrative materials are presented in Appendix D and Appendix E. Appendix F provides information about the Consumer Price Index for All Urban Consumers.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Definitions

22. For purposes of this Statement, certain terms are defined as follows:

- a. *Constant dollar accounting.* A method of reporting financial statement elements in dollars each of which has the same (i.e., constant) general purchasing power. This method of accounting is often described as accounting in units of general purchasing power or as accounting in units of current purchasing power.
- b. *Current cost accounting.* A method of measuring and reporting assets and expenses associated with the use or sale of assets, at their current cost or lower recoverable amount at the balance sheet date or at the date of use or sale.
- c. *Current cost/constant dollar accounting.* A method of accounting based on measures of current cost or lower recoverable amount in terms of dollars, each of which has the same general purchasing power.
- d. *Current cost/nominal dollar accounting.* A method of accounting based on measures of current cost or lower recoverable amount without restatement into units, each of which has the same general purchasing power.
- e. *Historical cost/constant dollar accounting.* A method of accounting based on measures of historical prices in dollars, each of which has the same general purchasing power.
- f. *Historical cost/nominal dollar accounting.* The generally accepted method of accounting, used in the primary financial statements, based on measures of historical prices in dollars without restatement into units, each of which has the same general purchasing power.
- g. *Income from continuing operations.* Income after applicable income taxes but excluding the results of discontinued operations, extraordinary items, and the cumulative effect of accounting changes.

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- h. *Public enterprise.* A business enterprise (a) whose debt or equity securities are traded in a public market on a domestic stock exchange or in the domestic over-the-counter market (including securities quoted only locally or regionally) or (b) that is required to file financial statements with the Securities and Exchange Commission. An enterprise is considered to be a public enterprise as soon as its financial statements are issued in preparation for the sale of any class of securities in a domestic market.

Applicability and Scope

23. The requirements of this Statement apply to public enterprises that prepare their primary financial statements in U.S. dollars and in accordance with U.S. generally accepted accounting principles and that have, at the beginning of the fiscal year for which financial statements are being presented either:

- a. Inventories and property, plant, and equipment¹ (before deducting accumulated depreciation, depletion, and amortization) amounting in aggregate to more than \$125 million; or
- b. Total assets amounting to more than \$1 billion (after deducting accumulated depreciation).

Both amounts shall be measured in accordance with generally accepted accounting principles as reported in the primary financial statements (consolidated if applicable) of the enterprise.

24. The requirements of this Statement do not apply, during the year of a business combination accounted for as a pooling of interests, to an enterprise created by the pooling of two or more enterprises, none of which individually satisfies the size test described in paragraph 23.

25. The Board encourages nonpublic enterprises and enterprises that do not meet the size test in paragraph 23 to present the information called for by this Statement.

¹ For the purposes of this Statement, except where otherwise provided, inventory and property, plant, and equipment shall include land and other natural resources and capitalized leasehold interests but *not* goodwill or other intangible assets.

26. This Statement does not change the standards of financial accounting and reporting used for the preparation of the primary financial statements of the enterprise.

27. The information required by this Statement shall be presented as supplementary information in any published annual report that contains the primary financial statements of the enterprise except that the information need not be presented in an interim financial report. The information required by this Statement need not be presented for segments of a business enterprise although such presentations are encouraged.

28. An enterprise that presents consolidated financial statements shall present the information required by this Statement on the same consolidated basis. The information required by this Statement need not be presented separately for a parent company, an investee company, or other enterprise in any financial report that includes the results for that enterprise in consolidated financial statements.

Requirement for Supplementary Information

29. An enterprise is required to disclose:

- a. Information on income from continuing operations for the current fiscal year on a historical cost/constant dollar basis (paragraphs 39–46)
- b. The purchasing power gain or loss on net monetary items for the current fiscal year (paragraphs 47–50).

The purchasing power gain or loss on net monetary items shall *not* be included in income from continuing operations.

30. An enterprise is required to disclose:

- a. Information on income from continuing operations for the current fiscal year on a current cost basis (paragraphs 51–64)
- b. The current cost amounts of inventory and property, plant, and equipment at the end of the current fiscal year (paragraph 51)

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- c. Increases or decreases for the current fiscal year in the current cost amounts of inventory and property, plant, and equipment, net of inflation (paragraphs 55 and 56).

The increases or decreases in current cost amounts shall *not* be included in income from continuing operations.

31. In some circumstances, there may be no material difference between the amount of income from continuing operations on a historical cost/constant dollar basis and the amount of income from continuing operations on a current cost basis. In those circumstances, the current cost information listed in paragraph 30 need not be disclosed for the fiscal year concerned, but the enterprise is required to state, in a note to the supplementary disclosures, the reason for the omission of the information.

32. Information on income from continuing operations (on a historical cost/constant dollar basis or on a current cost basis) may be presented either in a "statement format" (disclosing revenues, expenses, gains, and losses) or in a "reconciliation format" (disclosing adjustments to the income from continuing operations that is shown in the primary income statement). Whichever format is used, such information should disclose, unless they are immaterial, the amounts of or adjustments to cost of goods sold, depreciation, depletion, and amortization expense and (in the case of historical cost/constant dollar income from continuing operations) reductions of the historical cost amounts of inventory, property, plant, and equipment to lower recoverable amounts as required by paragraph 44. Formats for the presentation of the supplementary information are illustrated in Appendix A.

33. If depreciation expense has been allocated among various expense categories in the supplementary computations of income from continuing operations (for example, among cost of goods sold and other functional expenses), the aggregate amount of depreciation expense, on both a historical cost/constant dollar basis and a current cost basis, shall be disclosed in a note to the supplementary information.

34. An enterprise shall disclose, in notes to the supplementary information:

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- a. The principal types of information used to calculate the current cost of inventory, property, plant, and equipment, cost of goods sold, and depreciation, depletion, and amortization expense (paragraph 60)
 - b. Any differences between (1) the depreciation methods, estimates of useful lives, and salvage values of assets used for calculations of historical cost/constant dollar depreciation and current cost depreciation and (2) the methods and estimates used for calculations of depreciation in the primary financial statements (paragraph 61)
 - c. The exclusion from the computations of supplementary information of any adjustments to or allocations of the amount of income tax expense in the primary financial statements (paragraph 54).

35. An enterprise is required to disclose the following information for each of its five most recent fiscal years (paragraphs 65 and 66):

- a. *Net Sales and Other Operating Revenues*
- b. *Historical Cost/Constant Dollar Information*
 - (1) Income from continuing operations
 - (2) Income per common share from continuing operations
 - (3) Net assets at fiscal year-end
- c. *Current Cost Information* (except for individual years in which the information was excluded from the current year disclosures in accordance with paragraph 31)
 - (1) Income from continuing operations
 - (2) Income per common share from continuing operations
 - (3) Net assets at fiscal year-end
 - (4) Increases or decreases in the current cost amounts of inventory and property, plant, and equipment, net of inflation
- d. *Other Information*
 - (1) Purchasing power gain or loss on net monetary items
 - (2) Cash dividends declared per common share
 - (3) Market price per common share at fiscal year-end.

All enterprises shall report, in a note to the five-year summary, the average level or the end-of-year level (whichever is used for the measurement of income from continuing operations) of the Consumer Price Index for each year included in the summary (paragraphs 40 and 41).

36. If an enterprise chooses to state net assets, in the five-year summary, at amounts computed from comprehensive financial statements prepared on a historical cost/constant dollar basis or on a current cost/constant dollar basis, that fact shall be disclosed in a note to the five-year summary (paragraph 66).

37. Enterprises shall provide, in their financial reports, explanations of the information disclosed in accordance with this Statement and discussions of its significance in the circumstances of the enterprise.

38. The disclosures summarized in paragraphs 29–37 are required by this Statement. Enterprises are encouraged to provide additional information to help users of financial reports understand the effects of changing prices on the activities of the enterprise.

Historical Cost/Constant Dollar Measurements

39. The index used to compute information on a constant dollar basis shall be the Consumer Price Index for All Urban Consumers, published by the Bureau of Labor Statistics of the U.S. Department of Labor.²

40. An enterprise that presents the minimum historical cost/constant dollar information required by this Statement shall restate inventory, property, plant, and equipment, cost of goods sold, depreciation, depletion, and amortization expense and any reductions of the historical cost amounts of inventory, property, plant, and equipment to lower recoverable amounts (paragraph 44) in constant dollars represented by the average level over the fiscal year of the Consumer Price Index for All Urban Consumers. Other financial statement elements need not be restated. An enterprise that chooses to present comprehensive financial statements on a historical cost/constant dollar basis may measure the components of those statements either in average-for-the-year constant dollars or in end-of-year constant dollars.

² The index is published in *Monthly Labor Review*. Those desiring prompt and direct information may subscribe to the Consumer Price Index (CPI) press release mailing list of the Department of Labor.

41. If the level of the Consumer Price Index at the end of the year and the data required to compute the average level of the index over the year have not been published in time for preparation of the annual report, they may be estimated by referring to published forecasts based on economic statistics or by extrapolation based on recently reported changes in the index.

42. Inventory and property, plant, and equipment (for computation of the amount of net assets at the end of the current fiscal year for inclusion in the five-year summary of selected financial data paragraph 35(b)(3)), cost of goods sold and depreciation, depletion, and amortization expense shall be measured at their historical cost/constant dollar amounts or lower recoverable amounts. Inventories may need to be reclassified as monetary assets at the date of the use on or commitment to a contract (Appendix D).

43. Measurements of historical cost/constant dollar amounts shall be computed by multiplying the components of the historical cost/nominal dollar measurements by the average level of the Consumer Price Index for the current fiscal year (or the level of the index at the end of the year if comprehensive financial statements are presented) and dividing by the level of the index at the date on which the measurement of the associated asset was established (i.e., the date of acquisition or the date of any measurement not based on historical cost). Those measurements may be restated in base-year dollars for inclusion in the five-year summary (paragraph 65).

44. If it is necessary to reduce the measurements of inventory and property, plant, and equipment, during the current fiscal year from historical cost/constant dollar amounts to lower recoverable amounts, the reduction shall be deducted in the computation of income from continuing operations.

45. Except as provided in paragraphs 42-44 and paragraph 61, the accounting principles used in computing historical cost/constant dollar income shall be the same as those used in computing historical cost/nominal dollar income. Only the measuring unit is changed.

46. Inventory, property, plant, and equipment, and related cost of goods sold and depreciation, depletion, and amortization expense

that are originally measured in units of a foreign currency shall first be translated into U.S. dollars in accordance with generally accepted accounting principles and then restated in constant dollars in accordance with the provisions of paragraph 43.

Purchasing Power Gain or Loss on Net Monetary Items

47. A monetary asset is money or a claim to receive a sum of money the amount of which is fixed or determinable without reference to future prices of specific goods or services. A monetary liability is an obligation to pay a sum of money the amount of which is fixed or determinable without reference to future prices of specific goods or services. The economic significance of monetary assets and liabilities (monetary items) depends heavily on the general purchasing power of money, although other factors, such as the credit worthiness of debtors, may affect their significance.

48. All assets and liabilities that are not monetary are non-monetary. The economic significance of nonmonetary items depends heavily on the value of specific goods and services. Non-monetary assets include (a) goods held primarily for resale or assets held primarily for direct use in providing services for the business of the enterprise, (b) claims to cash in amounts dependent on future prices of specific goods or services, and (c) residual rights such as goodwill or equity interests. Nonmonetary liabilities include (a) obligations to furnish goods or services in quantities that are fixed or determinable without reference to changes in prices or (b) obligations to pay cash in amounts dependent on future prices of specific goods or services.

49. Guidance on the classification of balance sheet items as monetary or nonmonetary is set forth in Appendix D to this Statement.

50. The purchasing power gain or loss on net monetary items shall be equal to the net gain or loss found by restating in constant dollars the opening and closing balances of, and transactions in, monetary assets and liabilities. An enterprise that presents comprehensive supplementary financial statements on a historical cost/constant dollar basis may measure the purchasing power

gain or loss in average-for-the-year constant dollars or in end-of-year constant dollars; other enterprises shall measure the purchasing power gain or loss in average-for-the-year dollars. An acceptable approximate method of calculating the purchasing power gain or loss on net monetary items is illustrated in Appendix E.

Current Cost Measurements

51. The current cost amounts of inventory and property, plant, and equipment shall be measured as follows:

- a. Inventories at current cost or lower recoverable amount (paragraphs 57–64) at the measurement date. (This provision is qualified by paragraph 53 in respect of any depletion expense included in the measurement of inventories.)
- b. Property, plant, and equipment (excluding income-producing real estate properties and unprocessed natural resources) at the current cost or lower recoverable amount (paragraphs 57–64) of the assets' remaining service potential at the measurement date.
- c. Resources used on partly completed contracts shall be measured at current cost or lower recoverable amount at the date of use on or commitment to the contracts.

52. An enterprise that presents the minimum information required by this Statement on current cost income from continuing operations shall measure the amounts of cost of goods sold and depreciation and amortization expense as follows:

- a. Cost of goods sold shall be measured at current cost or lower recoverable amount (paragraphs 57–64) at the date of sale or at the date on which resources are used on or committed to a specific contract. (This provision is qualified by paragraph 53 in respect of any depletion expense included in cost of goods sold.)
- b. Depreciation and amortization expense of property, plant, and equipment (excluding income-producing real estate properties and unprocessed natural resources) shall be measured on the basis of the average current cost or lower recoverable amount

(paragraphs 57–64) of the assets' service potential during the period of use.

Other revenues, expenses, gains, and losses may be measured by such an enterprise at the amounts included in the primary income statement. An enterprise that chooses to present comprehensive financial statements on a current cost/constant dollar basis may measure the components of those statements either in average-for-the-year constant dollars or in end-of-year constant dollars. (This paragraph is qualified by paragraph 64 for enterprises that are subject to rate regulation or other form of price control.)

53. This Statement does not contain provisions for the measurement, on a current cost basis, of income-producing real estate properties, unprocessed natural resources, and related depreciation, depletion, and amortization expense (paragraph 19). If an enterprise presents information on a current cost basis in an annual report for a fiscal year ended before December 25, 1980, it may measure the assets and the related expenses, described in this paragraph, at their historical cost/constant dollar amounts or by reference to an appropriate index of specific price changes.

54. The amount of income tax expense in computations of current cost income from continuing operations shall be the same as the amount of income tax expense charged against income from continuing operations in the primary financial statements. No adjustments shall be made to income tax expense for any timing differences that might be deemed to arise as a result of the use of current cost accounting methods. Income tax expense shall not be allocated between income from continuing operations and the increases or decreases in current cost amounts of inventory and property, plant, and equipment.

Increases or Decreases in the Current Cost Amounts of Inventory and Property, Plant, and Equipment

55. The increases or decreases in the current cost amounts of inventory and property, plant, and equipment represent the differences between the measures of the assets at their "entry dates" for the year and the measures of the assets at their "exit

dates" for the year. "Entry dates" means the beginning of the year or the dates of acquisition, whichever is applicable; "exit dates" means the end of the year or the dates of use, sale, or commitment to a specific contract whichever is applicable. For the purposes of this paragraph, assets are measured in accordance with the provisions of paragraph 51.

56. The increases or decreases in current cost amounts of inventory and property, plant, and equipment shall be reported both before and after eliminating the effects of general inflation. An enterprise that presents comprehensive supplementary statements on a current cost/constant dollar basis may measure increases or decreases in current cost amounts in average-for-the-year constant dollars or in end-of-year constant dollars; other enterprises shall measure those increases or decreases in average-for-the-year constant dollars. An acceptable approximate method of calculating the increases or decreases in current cost amounts and the inflation adjustment is illustrated in Appendix E.

Information about Current Costs

57. The current cost of inventory owned by an enterprise is the current cost of purchasing the goods concerned or the current cost of the resources required to produce the goods concerned (including an allowance for the current overhead costs according to the allocation bases used under generally accepted accounting principles), whichever would be applicable in the circumstances of the enterprise.

58. The current cost of property, plant, and equipment owned by an enterprise is the current cost of acquiring the same service potential (indicated by operating costs and physical output capacity) as embodied by the asset owned; the sources of information used to measure current cost should reflect whatever method of acquisition would currently be appropriate in the circumstances of the enterprise. The current cost of a used asset may be measured:

- a. By measuring the current cost of a new asset that has the same service potential as the used asset had when it was new

(the current cost of the asset as if it were new) and deducting an allowance for depreciation;

- b. By measuring the current cost of a used asset of the same age and in the same condition as the asset owned;
- c. By measuring the current cost of a new asset with a different service potential and adjusting that cost for the value of the differences in service potential due to differences in life, output capacity, nature of service, and operating costs.

Current cost may be measured by direct reference to current prices of comparable assets or methods such as functional pricing or unit pricing under which the current cost of a unit of service embodied in the asset owned is measured and the current cost per unit is multiplied by the appropriate number of service units.

59. If current cost is measured in a foreign currency, the amount shall be translated into dollars at the current exchange rate, that is, the rate at the date of use, sale, or commitment to a specific contract (in the cases of depreciation expense and cost of goods sold) or the rate at the balance sheet date (in the cases of inventory and property, plant, and equipment).

60. Enterprises may use various types of information to determine the current cost of inventory, property, plant, and equipment, cost of goods sold, and depreciation, depletion, and amortization expense.³ The information may be gathered and applied internally or externally and may be applied to single items or broad categories, as appropriate in the circumstances. The following types of information are listed as examples of the information that may be used, but they are *not* listed in any order of preferability. Enterprises are expected to select types of information appropriate to their particular circumstances, giving due consideration to their availability, reliability, and cost:

a. Indexation

- (1) Externally generated price indexes for the class of goods or services being measured

³ Cost of goods sold measured on a LIFO basis may provide an acceptable approximation of cost of goods sold, measured at current cost, provided that the effect of any decreases in inventory layers is excluded.

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- (2) Internally generated price indexes for the class of goods or services being measured
 - b. Direct pricing
 - (1) Current invoice prices
 - (2) Vendors' price lists or other quotations or estimates
 - (3) Standard manufacturing costs that reflect current costs.

Depreciation Expense

61. There is a presumption that depreciation methods, estimates of useful lives, and salvage values of assets should be the same for purposes of current cost, historical cost/constant dollar, and historical cost/nominal dollar depreciation calculations. However, if the methods and estimates used for calculations in the primary financial statements have been chosen partly to allow for expected price changes, different methods and estimates may be used for purposes of current cost and historical cost/constant dollar calculations.

Recoverable Amounts

62. The term "recoverable amount" means the current worth of the net amount of cash expected to be recoverable from the use or sale of an asset. If the recoverable amount for a group of assets is judged to be materially and permanently lower than historical cost in constant dollars or current cost, the recoverable amount shall be used as a measure of the assets and of the expense associated with the use or sale of the assets. Decisions on the measurement of assets at their recoverable amounts need not be made by considering assets individually unless they are used independently of other assets.

63. Recoverable amounts may be measured by considering the net realizable values or the values in use of the assets concerned:

- a. Net realizable value is the amount of cash, or its equivalent, expected to be derived from sale of an asset net of costs required to be incurred as a result of the sale. It shall be considered as a measurement of an asset only when the asset concerned is about to be sold.

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- b. Value in use is the net present value of future cash flows (including the ultimate proceeds of disposal) expected to be derived from the use of an asset by the enterprise. It shall be considered as a measurement of an asset only when immediate sale of the asset concerned is not intended. Value in use shall be estimated by discounting expected future cash flows at an appropriate discount rate that allows for the risk of the activities concerned.

64. An enterprise that is subject to rate regulation or other form of price control may be limited to a maximum recovery through its selling prices, based on the nominal dollar amount of the historical cost of its assets. In that situation, nominal dollar/historical costs may represent an appropriate basis for the measurement of the recoverable amounts associated with the assets at the end of the fiscal year. Recoverable amounts may also be lower than historical costs. However, cost of goods sold and depreciation, depletion, and amortization expense shall be measured at historical cost/constant dollar amounts (in measurements of historical cost/constant dollar income from continuing operations) or at current cost (in measurements of current cost income from continuing operations) provided that replacement of the service potential provided by the related assets would be undertaken, if necessary, in current economic conditions; if replacement would not be undertaken, expenses shall be measured at recoverable amounts.

Five-Year Summary of Selected Financial Data

65. The information presented in the five-year summary shall be stated either:

- a. In average-for-the-year constant dollars or end-of-year constant dollars (whichever is used for the measurement of income from continuing operations) as measured by the Consumer Price Index for All Urban Consumers for the current fiscal year; or
- b. In dollars having a purchasing power equal to that of dollars of the base period used by the Bureau of Labor Statistics in calculating the Consumer Price Index (currently 1967).

66. If an enterprise presents the minimum information required by this Statement, it shall measure net assets (i.e., shareholders' equity) for the purposes of the five-year summary:

- a. On a historical cost/constant dollar basis at the amount reported in its primary financial statements adjusted for the difference between the historical cost/nominal dollar amounts and the historical cost/constant dollar amounts or lower recoverable amounts of inventory and property, plant, and equipment
- b. On a current cost basis at the amount reported in its primary financial statements, adjusted for the difference between the historical cost/nominal dollar amounts and the current cost or lower recoverable amounts of inventory and property, plant, and equipment and restated in constant dollars in accordance with paragraph 65.

If an enterprise elects to present comprehensive supplementary financial statements on a current cost/constant dollar basis, or on a historical cost/constant dollar basis, it may report the amount of net assets in the five-year summary in accordance with the comprehensive statements.

Effective Date and Transition

67. The provisions of this Statement shall be effective for fiscal years ended on or after December 25, 1979. However, information on a current cost basis for fiscal years ended before December 25, 1980 may be presented in the first annual report for a fiscal year ended on or after December 25, 1980.

68. An enterprise is required to state, in the five-year summary of selected financial data, only the following amounts for fiscal years ended before December 25, 1979: net sales and other operating revenues, cash dividends declared per common share, and market price per common share at fiscal year-end (paragraph 35(a), (d)(2), and (d)(3)). Disclosure of the other items listed in paragraph 35, for fiscal years ended before December 25, 1979 is encouraged. Disclosure of current cost information in the five-year summary (paragraph 35(c)) for fiscal years ending

before December 25, 1980 may be postponed to the first annual report for a fiscal year ending on or after December 25, 1980.

69. An enterprise that first applies the requirements of this Statement for a fiscal year ended on or after December 25, 1980 is required to state for earlier years, in its five-year summary, only the following items listed in paragraph 35: net sales and other operating revenues (item (a)), cash dividends declared per common share (item (d)(2)), and market price per common share at fiscal year-end (item (d)(3)). Disclosure of the other items listed in paragraph 35 for earlier years is encouraged.

**The provisions of this Statement need
not be applied to immaterial items.**

Members of the Financial Accounting Standards Board:

Donald J. Kirk, *Chairman*
Frank E. Block
John W. March
Robert A. Morgan
David Mosso
Robert T. Sprouse
Ralph E. Walters

This Statement was adopted by the affirmative votes of five members of the Financial Accounting Standards Board. Messrs. Mosso and Walters dissented.

Mr. Mosso dissents because he believes that the Statement does not bring the basic problem it addresses—measuring the effect of inflation on business operations—into focus. Because of that he doubts that it will effectively communicate the erosive impact of inflation on profits and capital and the significance of that erosion on all who have an investment stake in business enterprises. The Statement seems to him to fail the cost-benefit test because potential benefits are diminished by diffusion and some costs are unnecessary regardless of benefits.

The lack of focus stems from the dual reporting requirements imposed by this Statement, reporting on both historical cost/constant dollar and current cost bases, and is compounded by the ambivalence of the income concepts in both approaches. The Statement offers at least four income numbers—historical cost/constant dollar or current cost, each with or without adjustments for purchasing power gains or losses on monetary items. Other income combinations are invited in the current cost approach because of the juxtaposition of the increase or decrease in current cost amounts of assets. This array of income numbers is a good reflection of the range of views existing among the Board's respondents; but a good mirror does not make a good standard.

Mr. Mosso does not share the widely-held view that the historical cost/constant dollar and current cost models have different objectives. The objective is the same: To measure the effect of inflation on a business enterprise. But there are two types of inflation effect. The Board's historical cost/constant dollar model captures one type, the effect of inflation on the purchasing power of money invested in a particular business. The Board's current cost model captures both types. It incorporates some features of the constant dollar model and also the effect on the prices of goods and services that a particular business deals in. Inflation affects different specific prices in different ways. Consequently, information about changes in an index of general inflation does not provide sufficient information about the effect of inflation on a specific business enterprise. The current cost model is a more comprehensive inflation measurement approach and it makes a free standing historical cost/constant dollar model superfluous.

The constant dollar approach has two uses that he would support: One, as a method of computing simple one-line adjustments of net income and owners' equity in the primary historical cost financial statements, in conjunction with current cost supplemental statements (a proposal that deserves more support than it has received so far); or two, as an integral part of a supplemental current cost model, essentially as in the current cost approach required by this Statement. As a complete model, however, the historical cost/constant dollar approach has little to recommend it except seniority.

A major criterion that the Board has established for choosing among alternative disclosures is usefulness of the information for predicting earnings and cash flows. The evidence presented to the Board on usefulness in this sense was sketchy, but virtually all of it favored the current cost approach. In fact, usefulness for predicting earnings and cash flows was rarely associated with the historical cost/constant dollar approach, even by its supporters.

Beyond the investor-oriented usefulness criterion, the current cost model bears directly on an urgent national economic policy issue, that of capital formation and its corollary, productivity. The current cost model is built around the notion of maintaining operating capacity, and the distributable income concept that goes with it is designed to trigger attention at the point where reduction of capacity sets in. The whole system pivots on the point where capital investment begins to rise or fall. In the historical cost/constant dollar model, reduction of operating capacity can occur without showing up in the financial statements. This is not to suggest that it is a function of the Board to design accounting standards to promote economic policy objectives. But it is a function of the Board to design standards that measure business income and investment and to be aware, in doing so, of the broader economic consequences of standards. The current cost model has the potential for measuring and communicating many effects of inflation in ways that will be useful both to investors, to policy makers, and to the business community.

Much of the resistance to current cost accounting derives from two interrelated misconceptions: First that it is a major step toward current value accounting and second that its measurements are subjective and open to income manipulation. These are valid concerns. They should not be dismissed or lulled. But neither is an inherent concomitant of current cost accounting.

The essence of current value accounting is revenue recognition on some prerealization basis. The increases in current cost amounts of assets (so-called "holding gains") arising in a current cost model can be viewed as income equivalents, but that view is not necessary. The model can classify those items as capital maintenance adjustments—necessary to keep the business on a level output trendline.

Subjectivity of measurement is also associated with the current cost model because in theory it breaks the link to historical transaction prices. In practice, this need not be a problem. Indexing can maintain a linkage to historical prices and preserve objectivity and reliability. Many other current costing techniques compare favorably, in terms of objectivity, with historical cost allocation techniques.

In Mr. Mosso's view, conventional accounting measurements fail to capture the erosion of business profits and invested capital caused by inflation. The urgent need is to focus attention on that basic problem. To do that effectively, it is essential to settle on a single inflation-adjusted bottom line within a framework that captures the price experience of individual firms. The door should be closed quickly and firmly on the dual approach with multiple income numbers.

Mr. Walters dissents because he believes that the dual approach in this Statement unfortunately attempts to deal with two very important but fundamentally different issues in combination. The result is most confusing.

The first issue is the need to measure and report the impact on the enterprise of the change in the exchange value of money. This need is urgent. Paton said: "A summation of unlike monetary units, even of the same name, is a misrepresentation." The integrity of the historical cost/nominal dollar system relies on a stable monetary system. We have experienced several decades of continuing debasement of the currency. It is essential to the credibility of financial reporting to recognize that the recovery of the real cost of investment is not earnings—that there can be no earnings unless and until the purchasing power of capital is maintained. The constant dollar information required by this Statement, provided one takes the monetary adjustment into consideration, will generally accomplish this within a reasonable order of magnitude. It is not experimental. It is ready to go.

The second issue is the need to introduce current costs or values into the financial reporting model. The record built in the Board's due process indicates that the Securities and Exchange Commission, some educators, and some financial analysts perceive such a need. Issuers of financial statements and auditors, in the main, either do not perceive a need at this time, or believe the proposed model needs further development and testing or that the costs exceed the benefits.

The current cost information introduced in this Statement has significant limitations. It is neither a comprehensive current cost nor a value system. It identifies as income from continuing operations an amount that is sometimes referred to as "distributable income." This amount may have use in funds flow analysis, but it is neither distributable nor income. In most cases, it is a result of subtracting the estimated cost of the next purchase from the revenue from the last sale. It is neither transaction-based income nor real economic income. It has no "bottom line." It is best an intermediate step, easily misinterpreted.

To reduce complexity, the Board elected to defer action or deal inconclusively with such significant matters as backlog depreciation, holding gains, tax allocation, gearing adjustments, and liability measurement. The sacrifice of completeness for understandability leaves us with a model that falls short of the mark on both counts.

This Statement reflects diverse views on the best way to report the effects of changing prices. The resulting product has something for everybody, but by requiring a number of supplemental income amounts which can be used in various combinations, it does not focus on a concept of real income. It offers a smorgasbord of data that fail to meet the tests of simplicity, understandability, and therefore cost-effectiveness.

The weight of evidence suggests that the Board is promulgating a current cost model that is not ready, for a constituency that is not ready for it. Experimentation with current cost and value information is sorely needed to establish their feasibility, reliability, cost, and usefulness. Mr. Walters believes that this experimentation should be conducted with volunteer companies working through professional organizations of business executives, accountants, and financial analysts. Regulators mandate experiments in financial reports; standard setters should not.

